UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT

COMMERCIAL LEGAL AND INSTITUTIONAL REFORM (C-LIR) ASSESSMENTS FOR EUROPE AND EURASIA

Diagnostic Methodology Handbook

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I. OVERVIEW

This *Handbook* has been prepared to assist commercial law and institutional reform (C-LIR) specialists to apply proven methodology for understanding the commercial law environment in a developing or transition country so that they can design better programs of assistance. Just as importantly, it is a tool for helping policy makers understand the need for and dynamics of specific commercial law reforms. The methodology, as further described below, was developed over a two-year period between 1998-2000, and field tested in seven countries of the Europe/Eurasia region.

The diagnostic methodology is both qualitative and quantitative. Qualitative aspects of the commercial law environment are assessed through a systematic examination of laws and the institutions necessary for the implementation of those laws. Findings are quantified by assigning numerical values to the qualitative judgments. These two facets together provide a more complete picture than qualitative assessments with no scoring. Quantification permits both a standard for comparison with other countries and between areas of law, while providing a "reality check" on the integrity of the assessment.

This tool was thus intended to result in both a written, qualitative report on the areas of law studied, and a set of scores based on the indicators provided. The scores, by themselves, have little more than academic value without a supporting discussion. The qualitative findings, however, can stand alone without the scores, but are strengthened by the numerical back-up, which can be used very effectively to sensitize planners to the need for change.

In the end, this diagnostic tool is meant to be just that -- a practical *tool* for designing and prioritizing programs of assistance in the area of commercial law reform. It can be modified to fit the needs of the users, and expanded to other areas of laws not covered yet. Within USAID, the diagnostic scores provide a growing database of comparative indicators. For those who do not need such indicators, the methodology still provides the in-depth systematic analysis necessary for effective strategic planning.

Below, the *Handbook* provides a brief background on the how the methodology was developed, a glossary of terms used, an explanation of how scores are calculated (with examples from prior assessments), and general comments on each of the four dimensions of the assessment. Following these general discussions is a separate section for each of the seven areas of law, including comments and the indicators themselves.

II. BACKGROUND

Project Design

Since the fall of communism, most of the countries of Central and Eastern Europe and the former Soviet Union have been making the difficult transition toward a market economy. Early on in this process, it became clear that commercial law reform was a critically important component in a broad range of reform initiatives needed to promote the efficient operation of a market economy. Intuitively, many realized that because commercial laws serve as the “rules of the game” for a market economy, it was critical to get them "right" if a free market was to flourish.

Recognizing this, reformist governments began to tackle legal reform generally, and commercial law reform specifically. To assist with this process, international donor agencies such as the World Bank, the International Monetary Fund, the European Bank for Reconstruction and Development, the European Union, the German Development Agency (GTZ), along with USAID and its partner agencies in the U.S. government, lent support by fielding an army of short- and long-term technical advisors to provide an ar-

ray of technical advisory services. The success of these early efforts - referred to here as *1st generation* commercial legal and institutional reform (C-LIR) - were mixed. New laws were drafted (sometimes copied verbatim from advanced market economies) and enacted, but with little lasting change. Two important lessons were learned during this early phase of C-LIR. First, getting the Legal Framework "right" is an essential, but not sufficient, precondition for sustainable, market-driven economic growth. Second, without a supporting institutional framework, and associated capacity, commercial laws cannot be fully implemented or enforced.

These lessons served as the basis for the *2nd generation* in C-LIR as a distinct area of economic development theory and practice. During this second phase, practitioners' attention turned to rationalizing and strengthening the institutional framework for implementation and enforcement of commercial and other laws. This led to important advances in institutional and operational analysis, regulatory design, and capacity building. The international donor community to address institutional deficiencies marshaled policy advisors, technical training, and limited equipment procurements. The record of success for these 2nd generation interventions has been somewhat better - but still not what was hoped for. While significant gains were achieved in certain substantive areas (e.g., GATT/WTO accession, customs administration, collateral registries, and capital markets), there was little progress in others - notably in the enforcement of bankruptcy, antitrust, and intellectual property laws. This practical experience in the field brought to light the complexity and subtlety of the institutional dimension of C-LIR.

This *Handbook* is the result of a project representing a tangible and significant commitment of resources by USAID to advance a "3rd generation" of C-LIR. Despite some success in the field, there is a growing recognition that the legal and institutional elements of C-LIR are two parts of a larger and more complex whole. The evidence to support this conclusion lies in the "implementation/enforcement gap" that has been observed even after technically competent 1st and 2nd generation C-LIR initiatives have been carried out. The 3rd generation of C-LIR will be distinguished by its focus on achieving sustainability in implementation and enforcement of legal and institutional reforms.

Addressing the Challenge

The challenge of the 3rd generation of C-LIR is to develop a cost-effective, results-oriented approach (or approaches) that will help close the implementation/enforcement gap described above. In 1998, USAID began to address this challenge through a project that has led to this *Handbook*. The project was developed with five principal objectives in mind:

1. Develop a more comprehensive understanding of the evolution and outcome of C-LIR in transition and developing countries;

2. Build USAID's internal capacity to define, measure, and evaluate C-LIR results by designing and testing appropriate quantitative and qualitative performance indicators;

3. Facilitate a discussion within USAID, and between USAID and host-country counterparts, on the impact of C-LIR initiatives and implications for possible future interventions;

4. Develop and test new strategies for closing the "implementation/enforcement gap" through pilot and rapid-response C-LIR technical assistance interventions; and,

5. Design and construct a USAID C-LIR resource base containing the cumulative results of this initiative for use in the development, implementation and assessment of future LIR interventions in Europe, Eurasia and other regions in which USAID operates.

USAID contracted Booz·Allen & Hamilton through competitive bidding to design a system to meet these challenges. Working together, they established a C-LIR design team to construct a diagnostic methodology (Objective 2) that would provide a deeper understanding legal reforms efforts in developing and transition countries (Objective 1), which would in turn serve as the foundation for fulfilling the other objectives.

Focusing their analysis, the C-LIR team chose seven areas of commercial law considered fundamental to economic growth and the development of a market economy: bankruptcy, collateral, company, competition, contract, foreign direct investment, and trade. Although other areas can be added -- and in some countries perhaps should be -- these seven formed the basis for comparative analysis in designing the overall methodology.

USAID's experience with first and second generation reforms and the implementation/enforcement gap showed that laws and institutional structures were a starting point, not the whole picture. The C-LIR team, therefore, expanded the analysis for each area of law into four dimensions: Framework Laws, Implementing Institutions, Supporting Institutions, and the Market for Reform. As further discussed below, indicators were developed for each of the four dimensions in each of the seven areas of law, along with a system of scoring the answers. The result was a set of 28 "score sheets" to be used as the basis for assessment.

Testing the Tools

While developing the methodology, the team began field testing the new approach through in-country diagnostic assessments. Small teams of three legal specialists visited Kazakhstan, Poland, Romania, and Ukraine, for periods of up to three weeks between October 1998 and June 1999. They prepared both written reports and scores for each country, then convened in the summer of 1999 to compare scores and results. The C-LIR team analyzed these findings and prepared a synthesis report to be critiqued by the development community.

USAID convened almost 60 legal reform specialists from the Europe/Eurasia region for three days in December 1999 to examine the methodology and the results at a workshop in Prague. The workshop was attended by USAID C-LIR specialists, local counterparts from the legal community, including lawyers and judges, and representatives from the World Bank, the Organization of Economic Cooperation and Development (OECD), the European Bank for Reconstruction and Development, the Federal Trade Commission (FTC), and the US Department of Commerce.

Through general sessions and break-out working groups, the workshop participants reviewed the results for each country and the methodology for each area of law. While recommending minor changes to the approach, they affirmed the overall findings, the methodology, and the conceptual framework. Indeed, several USAID mission representatives at the conference went beyond affirmation -- they requested assessments for their countries.

Refinements and Revisions

After the Prague workshop, the C-LIR team adopted the recommended changes and performed three more assessments, in Albania, Croatia, and Macedonia. Several new members were used in the assessment teams to ensure that the methodology was transferable, and had not become "in-grown" for use only by

the designers. Experience gained in these areas resulted in additional refinements and the production of this final version.

In addition, the USAID missions were able to test the premise that this diagnostic methodology was a tool for their own programmatic needs. In all cases, the missions were able to use the results for strategic planning purposes, and in Croatia, the mission immediately introduced technical assistance programs to address some of the constraints identified in the assessment.

The diagnostic methodology presented below has thus been affirmed as a theoretically sound and practically useful tool for understanding the commercial law environment and addressing assistance needs.

III. GLOSSARY OF KEY TERMS & CONCEPTS

Bankruptcy - Mechanisms intended to facilitate orderly Market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors. Should be read to include "insolvency".

Collateral - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets. This term should be read to include "secured transactions".

Companies - Legal regime(s) for Market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.

Commercial Law- Any one or more of seven areas of substantive law defined for the purposes of this study to include Bankruptcy, Collateral, companies, Competition, Contract, foreign direct investment, and International Trade laws, and associated institutions.

Competition - The legal and regulatory regime consisting of a body of rules, policies and Supporting Institutions intended to help promote and protect open, fair and economically efficient Competition in the Market, and for the Market.

Contract - The legal and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.

Foreign Direct Investment - The laws, procedures and institutions that regulate the treatment of foreign direct investment.

"Dimension" - One or more of four elements that together make up the legal and institutional environment for modern commercial life. These include "Framework Laws", "Implementing Institutions", "Supporting Institutions" and, the "Market" for C-LIR.

End Users - Individuals and firms who use, or rely upon, the provision of goods (e.g., laws, regulations, licenses, certifications, etc.) or services (e.g., administration, adjudication, enforcement, etc.) provided by government (or its agents) that relate to commercial activity.

Implementing Institution - The administrative body with primary responsibility for implementation and enforcement of framework and subsidiary laws, regulations, and policies governing one or more of the seven areas of commercial law assessed in this study; one of four Dimensions that together make up the

legal and institutional environment for modern commercial life. For example, Bankruptcy Courts are the Implementing Institution for the Bankruptcy Framework Law.

Indicator - A point of reference or benchmark, whether quantitative or qualitative, against which a sample can be compared, measured, or evaluated.

Indicator Result - The value of an indicator's raw score divided by the reference value for that indicator. For example, a raw score of 54, divided by the indicator's reference value of 140, would yield an indicator result of 39%.

International Trade - The laws, procedures and institutions governing cross-border sale of goods and services.

"Market" for C-LIR - One of four Dimensions that together make up the legal and institutional environment for modern commercial life. The "Market" for C-LIR is a conceptual framework that helps characterize the dynamic of modern pluralistic society in which End Users "demand" and government "supplies" certain public goods and services that are necessary for modern commercial activity. For example, rent-seeking behavior by a local bread monopoly can give rise to demand by consumers (End Users) for specific remedial action by the government (i.e., enforcement of antimonopoly regulations) against offending firms.

Raw Score - The point value score of an indicator based on the data collected for that indicator.

Supporting Institution - One of four Dimensions that together make up the legal and institutional environment for modern commercial life. Firms, individuals, or activities without which Framework Laws cannot be fully or efficiently implemented or enforced. Examples include notaries, bailiffs, trustees, banks, consumers groups, business support organizations, professional associations, and other similar ancillary service providers.

IV. INDICATOR DESIGN & DEVELOPMENT

A. Challenges of Indicator Design

Indicators are, by definition, comparative. The utility of indicators, particularly quantitative indicators, is that they permit ready comparisons between varying samples and over time. They are a useful shortcut - a means of *estimating* - without actually measuring every detail of a larger, complex whole. Indicators' usefulness, therefore, derives more from convenience than comprehensiveness. Viewed from this perspective, an "ideal" indicator is one that permits meaningful, reliable, and cost-effective comparisons between dissimilar examples.

Developing common indicators for commercial law development across a large region implies the ability to compare "*apples with apples*". From an historical and practical standpoint, however, this approach is overly general. While the Europe/Eurasia region (for example) as a whole falls within the Continental legal system that arose out of the Roman legal tradition, individual countries' commercial laws derive from different historical antecedents. Romania's commercial law follows the French tradition based on the *Code Napoleon*. Poland's commercial laws, in contrast, are based on the scientific rationalism of 19th Century Germany. Another layer of complexity is added in the form of Socialist legal theory and practice. While based on the German Rationalist tradition, "Socialist Law" has its own unique traditions and values that are distinct from the Continental legal system. The differences that each of these historical variations have on the development of modern commercial law and practice are subtle, yet real. It is therefore particularly important to develop indicators that focus on *outcomes*, rather than the relative advantages of one legal system over another.

"Development" implies growth and maturity -- a comparison to an ideal standard. Typically, such comparisons are stated in terms of "more" and "less" developed. On an intuitive level, this kind of comparative assessment is made every day when economies are classed as "more", "less" and "least" developed based on certain economic and social criteria. The key challenge of this work, therefore, was to determine whether it is possible to develop a common set of indicators that will allow temporal (e.g., "before" and "after") as well as spatial (e.g., "north" vs. "south") comparisons that meet the ideal of yielding results that are meaningful, reliable, and cost-effective.

One approach to this challenge is to measure "development" against roughly comparable countries and/or roughly comparable stages of economic development. This approach - *benchmarking* - is useful for general comparative purposes, yet assumes a degree of similarity that may or may not exist in practice. For example, can Poland's commercial laws and institutions be usefully compared against Germany's, given that they share a common border and considerable commonality in their commercial and legal traditions? Could Kazakhstan's be compared directly with that of France? Aside from the technical problems associated with such direct comparisons, the fundamental weakness of this basic approach is the normative content upon which they rely. Hence, if cross-regional comparisons are to be possible, the specific indicators of development have to common to all, and abstracted sufficiently to eliminate bias arising from the peculiarities of the sample.

Another approach to designing indicators for commercial law development is to focus less on the "*how*" and more on the "*what*" by measuring specific steps or obstacles in a *process-driven* environment that can be roughly correlated with efficiency and hence "progress". For example, the number of administrative steps, length of time in process, total cost, number of companies registered are all possible measures of the development of Company Law in a given country. Constraints analyses focusing on barriers to foreign direct investment (FDI), and competitiveness analyses focusing on opportunities for increased exports, are two other examples of process-oriented analysis. While this approach lends itself to quantification, it is severely limited by the availability, completeness, and reliability of data upon such comparisons are made. Of the four countries examined, only Poland had data readily available that could serve as a

basis for a process-oriented analytical approach. In the remaining sample countries, relevant data were unavailable, inconsistent, or suspect, making process-oriented indicators an impractical design option in most cases.

Another particularly difficult aspect of this challenge lies in addressing the temporal dimension of development. This difficulty derives from the dynamic nature of commerce itself. The laws are, to a greater or lesser extent, reflective of contemporary commercial practice. The *Convention on International Sales of Goods* (CISG), for example, explicitly recognizes the importance of custom and usage in international commercial law.[1] As a body of norms based on behavior, the CISG is organic and therefore subject to change as commercial norms and practices change. The rapid increase in the use of the Internet as a medium of commerce, for example, is creating an entirely new set of commercial practices, and associated legal questions of first impression. Similarly, genetic engineering is giving rise to new areas of legal inquiry in the area of intellectual property, trade, investment and other key areas of commercial law. Viewed in this light, the design of commercial law indicators should be though as something approximating skeet shooting, where it is not the target, but its trajectory, that matters most.

B. Deciding What to Measure

Based on the above, it is clear that designing a common set of indicators for commercial law development is very much a process of compromise. The design effort proceeded on the assumption that it is possible to broadly identify what "better" and what is "worse" based on generally accepted international best practices, and overall economic performance. For example, it is assumed that some causal relationship exists between Poland's advanced legal traditions prior to World War II, its geo-strategic position in Europe, its aggressive approach to market reform, and its strong economic performance during the past decade. The same can be said of other countries in the region whose profiles in these areas are less favorable than Poland's.

The common indicators developed are intended to:

(1) Provide a common gauge by which commercial law frameworks can be compared against a standard based upon generally accepted international "best practice";
(2) Collect information about both *institutional capacity* of primary implementation bodies and *individual capacity* (e.g., regulatory and enforcement personnel) to the extent that cross-comparative data are available;
(3) Obtain information about the development of *supporting institutions* necessary for the efficient implementation and enforcement of framework laws by implementing institutions (e.g., notaries, registries, lawyers' associations, academic institutions, etc.).
(4) Capture data on the level of *demand* for reform by civil society within the specific areas of commercial law development defined in this study; and,
(5) Characterize a government's ability to *supply* products (e.g., framework laws, implementing regulations, courts) and services (e.g., judicial rulings, enforcement of judgments by executive agents, training, outreach) appropriate for the development of commercial activity.

"Commercial law" encompasses a great number of specific legal disciplines. For the purpose of this study, commercial law has been defined more narrowly defined to include the following specific substantive areas of law and their associated institutions:

1. ***Bankruptcy*** - Mechanisms intended to facilitate orderly market exit, liquidation of outstanding financial claims on assets and rehabilitation of insolvent debtors.

[1] *Art. 9.2, United Nations Convention on International Sales of Goods (1980).*

2. ***Collateral*** - Laws, procedures and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets.
3. ***Companies*** - Legal regime(s) for market entry and operation that define norms for organization of formal commercial activities conducted by two or more individuals.
4. ***Competition*** - Rules, policies and supporting institutions intended to help promote and protect open, fair and economically efficient competition in the market, and for the market.
5. ***Contract*** - The legal regime and institutional framework for the creation, interpretation and enforcement of commercial obligations between one or more parties.
6. ***Foreign Direct Investment*** - The laws, procedures and institutions that regulate the treatment of foreign direct investment.
7. ***Trade*** - The laws, procedures and institutions governing cross-border sale of goods and services

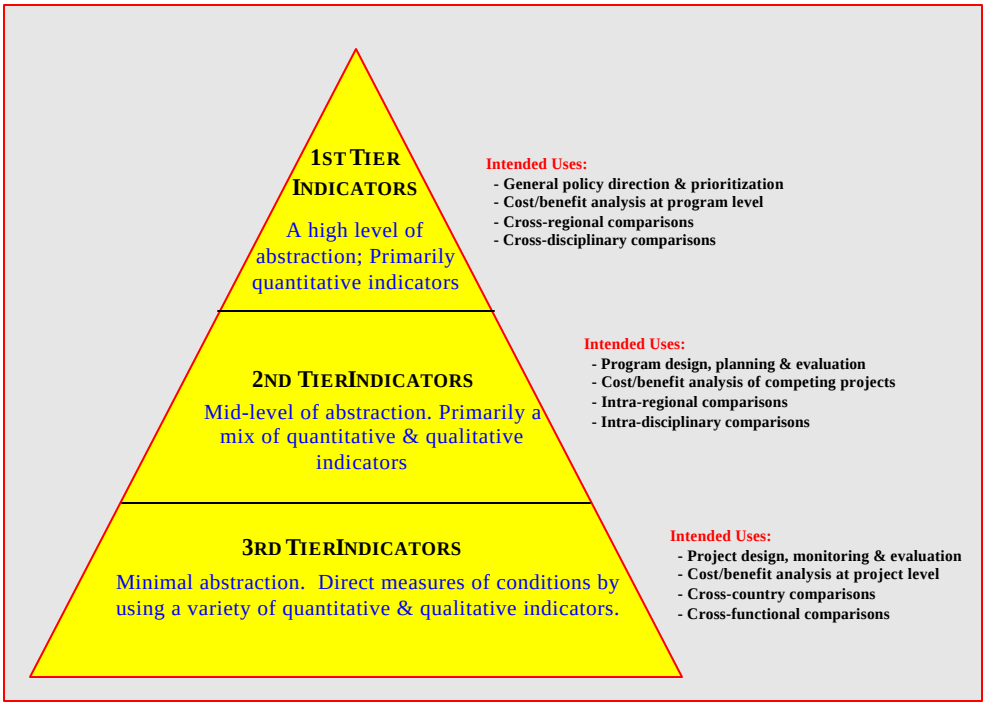
Within each of these substantive areas, four "Dimensions" of C-LIR are proposed as a conceptual framework for comparison. These include:

1. ***Framework Laws*** - Basic legal documents that define and regulate the substantive rights, duties, and obligations of affected parties and provide the organizational mandate for implementing institutions (e.g., Law on Bankruptcy, Law on Pledge of Moveable Property);
2. ***Implementing Institutions*** - Governmental, quasi-governmental or private institutions in which primary legal mandate to implement, administer, interpret, or enforce framework law(s) is vested (e.g., bankruptcy court, collateral registry);
3. ***Supporting Institutions*** - Governmental, quasi-governmental or private institutions that either support or facilitate the implementation, administration, interpretation, or enforcement of framework law(s) (e.g., bankruptcy trustees, notaries); and,
4. ***Market For C-LIR*** - The interplay of stakeholder interests within a given society, jurisdiction, or group that, in aggregate, exert an influence over the substance, pace, or direction of commercial law reform.

C. Organization and Structure of the C-LIR Indicators

The graphic below provides a conceptual overview of how the development indicators are organized.

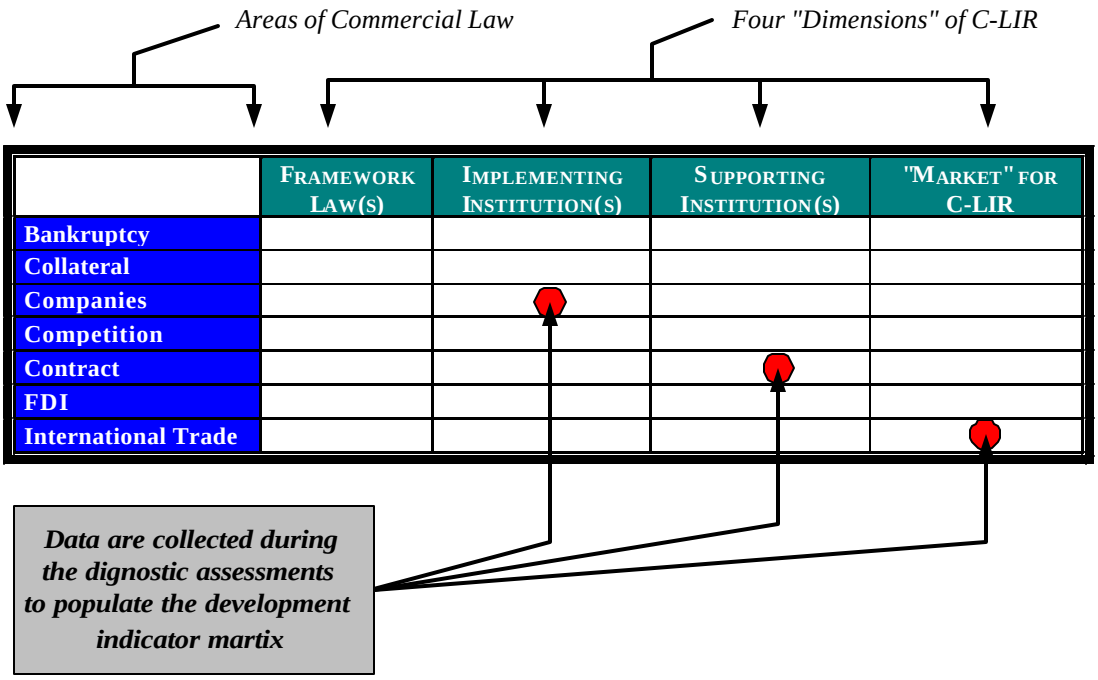
STRATEGY FOR C-LIR INDICATOR DEVELOPMENT & USE



Each of the three sections or "tiers" of the pyramid in the diagram represent a different level of detail or "abstraction" generated by the indicators. The primary objective in creating three tiers of indicators is to provide varying levels of detail, depending on the needs of the user. Generally speaking, 1st Tier indicators are intended to be useful to high level policymakers who are responsible for establishing general policy direction and prioritization. 2nd Tier indicators are intended to be most useful to senior program- and country-level officials responsible for program deign, planning, and evaluation. Finally, 3rd Tier indicators are designed to be most useful to those who need to make detailed analysis of specific areas of the commercial law environment in a given country, or between specific countries. In this case, those responsible for project design, monitoring and evaluation are most likely to find the level of detail at the Tier III level useful.

The organization of the data into tables that can be easily read and interpreted is also a challenge given the amount and complexity of the data required. As illustrated in the diagram below, basic indicator groups for a given country are organized into blocks of twenty-eight "cells". The four Dimensions of commercial law development appear across the top of the table, and the seven subject matter areas defined for this study appear in the far left column.

Conceptual Overview of C-LIR Development Indicators



Each of the seven areas of commercial law selected for assessment is measured across four dimensions, resulting in a total of 28 indicator groups for an overall assessment. For this reason, it is important for the user to have a firm grasp of the organization and logic of the indicator tables before attempting to interpret speicific indicator scores or results.

D. How To Read the C-LIR Indicator Tables

The diagram below represents how Tier I and Tier II results are organized in the C-LIR indicator tables. The subject matter area ("Collateral") appears in the upper left portion of the table. Below it, the four Dimensions of commercial law are listed in their order of treatment. The column immediately to the right ("Ref.") contains a "reference value" (i.e., benchmark) against which the sample countries (i.e., "A" through "D") are compared. To illustrate, the total raw scores for Country A and Country B are 228 and 235, respectively, as compared against the reference value of 638. These are referred to as Tier I *raw scores*. To obtain a Tier I *result*, the raw score is divided by the benchmark reference value (REF) to obtain Tier I results of 31% and 33% respectively. This example suggests that Country A's Collateral Law system is comparable in relative terms to Country B's *when viewed at the highest level of abstraction.*

BASIC INDICATOR TABLE ORGANIZATION

SUBSTANTIVE AREA	REF.	A		B		C		D	
COLLATERAL LAW	638	228	31%	235	42%				
Legal Framework	120	85	*71%*	90	75%				
Implementing Institution	226	72	*32%*	25	11%				
Supporting Institution	154	34	*22%*	67	44%				
"Market" for C-LIR	138	37	*27%*	53	38%				

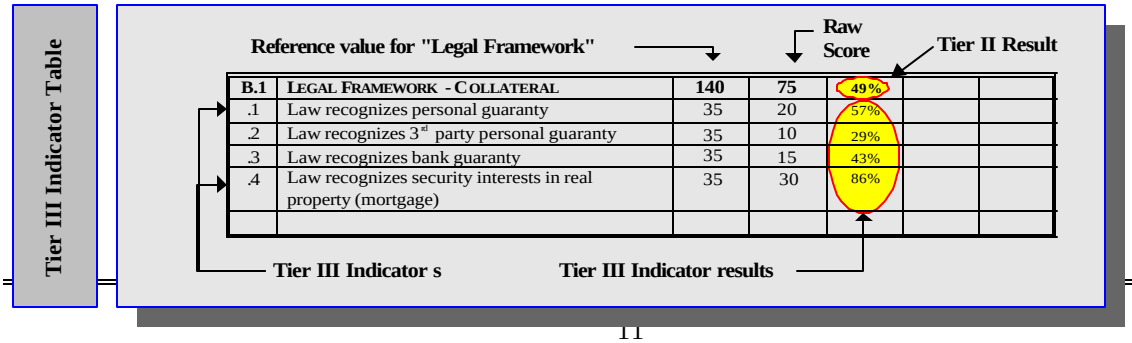
4 "Dimensions" of C-LIR

Tier II Reference Value

Tier I Indicator Results = the Average of Tier II Results

The same exercise can be performed at the Tier II level. If, for example the "Market for Collateral Law reform in Country A is compared to that of Country B, a result of 27% and 38% respectively is obtained. From this it may be possible to infer that the Market Dimension for this subject matter area (Collateral) is *relatively* stronger in Country B than in Country A in aggregate terms, but relatively weak in comparative terms. It must be emphasized that a more detailed analysis of the underlying Tier III indicator raw scores and results would be required to draw more specific conclusions (e.g., a relative quality of policies "supplied" in Country A).

The Tier I and Tier II indicators in the example above are derived from the raw data collected in the course of the diagnostic assessments. This raw data is collected and scored against Tier III indicators. As a result, Tier III indicators provide the foundation for this analysis. In the illustration below, Tier III indicator results for the "Legal Framework" for Collateral are averaged to yield associated Tier II results. Individual Tier III indicator results provide the highest level of detail in the analysis. In this example, the result for Indicator B.1.3 ("Law recognizes bank guaranty.") is 43%, which can be interpreted to mean that this particular aspect of the Legal Framework for Collateral was found to fall well short of the benchmark Reference Value of 35. Where pertinent, a more detailed discussion of the basis on which this particular Tier III scoring was made would appear in the narrative portion of the diagnostic report.



These examples are intended to help show how indicator results "roll up" from one level to the next in terms of abstraction. This design is intended to dilute the impact that any single indicator *raw score* may have on the overall indicator *result*. It is our intention that the impact of a small discrepancy (or bias) in scoring at the Tier III level from one country to the next would be minimized provided the assessment methodology is applied consistently in each case.

Users of this methodology should note that the country-by-country comparisons are now expressed only in terms of the percentile score. Changes in the indicators after the Prague workshop eliminated the ability to compare raw scores due to the many changes in indicators and their waiting after the workshop.

V. CONDUCTING THE DIAGNOSTIC ASSESSMENT

The methodology for the C-LIR diagnostic assessment was designed as a short-term, cost-effective tool to assist USAID missions in understanding the commercial legal environment for the purpose of refining program strategies and designing more effective projects. Actual assessments were conducted in seven countries: Albania, Croatia, Kazakhstan, Macedonia, Poland, Romania, and Ukraine. This practical experience has yielded a number of insights and recommendations for how to conduct the assessments effectively.

A. The Diagnostic Team

Level of Effort and Team Size. Teams of three or four expatriate legal specialists were used in six of the countries, and a team of two performed an abbreviated diagnostic (four areas of law instead of seven) in one country. Various levels of effort were used, but most teams spent a week or less in preparation, two or three weeks in country, and additional time finalizing the report (which was sometimes drafted prior to departure). Teams generally used a six-day work week in the field.

A team of three expatriate specialists is generally sufficient, if complemented by local support. It can be very useful to have one specialist, or a junior assistant, arrive in advance to arrange interviews and schedules for the full team, but this is not necessary when the USAID mission or other counterpart can provide such assistance.

Assuming that there is a local support to do advance scheduling, the following level of effort is recommended for each consultant, based on a team of three:

Preparation (internet research; review of laws, existing project papers and assessments, and other background information; setting up logistics with local support)	4-5 days
Field work (interviews, local meetings and research, preparation of draft report, preliminary scoring)	18 days
Follow-up (finalizing report, incorporating comments on draft)	4-5 days
Editorial clean-up and consolidation (one person only)	3 days

Team Composition. In order to provide an accurate diagnostic, taking into account regional traditions and historical influences, the diagnostic team should include both expatriate and local professionals. For assessments to date, expatriate members have included senior lawyers from the United States and Europe who had practiced both in the region and the U.S. Comparative legal experience is essential to provide comparisons between the general regional trends, specific country observations, and differences between these and the U.S. and western European legal systems. In addition, cooperating country national (CCN) lawyers and experts can be hired or utilized in country to provide key background information and input on the indicators, identify interview candidates, attend meetings, and provide the local view on legal traditions and reforms, as well as useful feedback on the team's findings. In addition, when necessary the team can use local junior lawyers to complete additional research and translations.

Dividing Responsibilities. The team should be divided into specialized areas of commercial law so that they can split up and cover the most ground possible during the diagnostic fieldwork. For example, one individual can cover trade and foreign direct investment, another focus on company and competition, and

the third handle bankruptcy, collateral and contract. Naturally, the divisions should be based upon the team members' own specialization or areas of familiarity. As many of the indicators cut across several areas of law, often a visit to a given Ministry, government office or private sector organization yield information on more than one area of law. In order to ensure that the relevant areas are covered, the team should confer frequently to compare notes, assess progress, and make mid-course adjustments.

B. Data Collection

Pre-departure Preparation. In order to facilitate in-country data collection, preliminary research on background information should be completed prior to the diagnostic. Generally, background information is available from the USAID country mission and Washington desk officers, including translations of relevant laws and legislation, statistical economic and trade information, earlier assessments of general and specific legal reform progress, and identification of relevant institutions and people to interview during the diagnostic. In addition, information can be gathered via the internet, international financial institutions and donor organizations, academic and legal sources, embassies, and discussions with business organizations and lawyers knowledgeable about the particular countries.

Both general and specific meetings and interviews should be arranged in advance so as to "hit the ground running" upon arrival in country. Gaps can be filled and indicator-specific questions answered as the diagnostic progresses. Where local administrative support is limited, it may be necessary to send someone in advance to arrange meetings and logistics.

Some information will only be available in-country from various ministries, agencies, and public institutions. If not available prior to departure, the team should plan to collect missing documentation in the field, and ask interview respondents for copies of any documents they deem relevant. Whatever the timing, the team should obtain, if possible, the following:

- Legislation and regulations for each area of law studied
- Basic information about the structure of the court system
- Organic documents and implementing regulations for Implementing Institutions
- Statistics or data (if available) about bankruptcy, civil litigation (case loads) and arbitration
- Information on how judgments are executed in the jurisdiction (including relevant legislation)
- Economic statistics and trade data; and
- Links to websites with relevant country information, including reports.

Before conducting the first interviews, the team members should attempt to score the framework law indicators for each area based on their own reading of the laws and documents obtained. This will allow them to identify gaps and uncertainties and to check their own understanding of the laws against that of the practitioners who actually apply the law regularly.

In the Field. In-country data collection should be conducted on a "360 degree" basis. That is, for each data point sought, an effort should be made to obtain information from as many relevant perspectives as possible, given limitations of time and resources. To take bankruptcy law as an example, small and large debtors and creditors, lawyers, judges, scholars, government officials, and business and legal advocacy groups were consulted in an effort to gain as complete a picture as possible of the development and adequacy of the framework law and relevant implementing and supporting institutions.

The importance of obtaining public *and* private-sector input cannot be overemphasized, especially with respect to the market for change. There are inherently different biases and experiences between those

who provide a service and those who receive the service. Each viewpoint deepens the overall analysis and serves as a reality check for other input.

In the same way, efforts should be made to visit areas outside of the capital city. There are often strong divisions (and rivalries) between headquarters and the hinterlands, in terms of experience, needs, and perceptions. For example, the courts in a district capital often have a different workload, level of efficiency, and internal structure from those in the national capital, no matter how unified they are supposed to be in practice. In addition, there are many countries in which "national" programs really only focus on the problems of the capital (or are perceived that way), leading to resentment in other locations. An inclusive interviewing structure can not only capture these sentiments, but help build understanding and future cooperation as the "outsiders" find themselves included in the process of program building.

Debriefing. The diagnostic team should meet frequently to compare results of separate interviews and identify data gaps. After the first week, it is advisable to attempt scoring

C. Interviews

Getting Started. As noted, initial interviews should be scheduled, if possible, prior to the arrival of the diagnostic assessment team. The USAID mission or other local counterpart can normally identify at least a significant handful of stakeholders as a starting point, and sometimes even set up an extensive schedule. If not, internet research into local organizations and agencies should enable the team to put together an initial list, including government officials, lawyers, company representatives, and others. Likewise, phone calls to development organizations, foreign investors, banks, and others can provide an excellent starting point.

Once in country, there are a number of excellent sources for people to interview. First, of course, are the sponsoring agencies. For USAID, there is usually at least one government agency or ministry that is a counterpart for the diagnostic assessment. Their representatives will normally have a very keen sense of whom should be included, can give names and contact information, and will often set up meetings for the team. Each respondent will from the initial list will usually have additional recommendations: indeed, the interview candidates themselves are often the best source of contacts.

Most countries have undergone various assessments related to law and commerce, and the reports often contain lists of contacts who participated in those assessments. While these are excellent sources of information, they should be used cautiously. If contacts are drawn primarily from previous lists, the assessment may repeat biases or weaknesses based on participants or methodology of the earlier assessment. In addition, "donor fatigue" may set in, with respondents unwilling to participate in yet another study, especially if they have never seen the results of the earlier studies.

Common sources for interviews may seem obvious, but are worth repeating:

- Telephone directories
- Directories of professional associations (lawyers, bankers, accountants, notaries)
- Subsidiaries of multi-national firms and businesses
- Chambers of commerce (local and international or bi-lateral)
- Colleges and university faculty, for relevant disciplines
- International business associations (Rotary International, Lions Club)
- Trade promotion organizations, including government agencies
- Advertisements in local publications

Impromptu interviews can also offer insights not found elsewhere. Proprietors of cybercafes, restaurants, and stores, as well as hotel managers and service providers, are often happy to participate, especially when given the opportunity to vent their frustrations about constraints to their endeavors.

Conducting Interviews. In some countries, government officials will require a letter of introduction from a relevant ministry official explaining the purpose and nature of the interview before they agree to a meeting. (This is especially true of the countries with a history of highly centralized, controlling governments.) Private sector participants are usually less formal, but sometimes want to see an outline or list of questions prior to meeting. If possible, the interviewer should provide a written overview of the assessment, and an outline of questions, or even a copy of the diagnostic indicators, several days before the meeting. (When possible, all such documentation should be provided in the local language.) This not only allows the participants to provide more thoughtful answers, but also allows them to bring in others who have a better grasp of the issues being discussed. At times, the participant will also find an appropriate replacement and avoid wasting the time of all involved.

Most respondents will be very willing to provide opinions on their area of expertise, and will often speak in abstractions. While these opinions of "good" and "bad" laws and institutions are useful, the diagnostic team should seek to obtain concrete facts, data, and specific examples as well. Such information can be used in other interviews to check facts and differing perspectives on controversial issues.

The diagnostic indicators can be used as an interview guide, providing both the broad outline and specific questions. Some participants may wish to provide their own scores before or after the interview, but this is not common due to the amount of time generally required for thoughtful scoring, especially if the participant's command of English is limited. Expatriates working on legal reform projects are often willing to provide scores based on their experience in country, and are a valuable source of information and analysis.

Cultural Considerations. Many developing and transition countries have suffered historically from oppressive hierarchies, and have found that honesty is not the best policy for job security. Among government officials and others, there can be pronounced hesitancy in providing open answers and honest opinions. The diagnostic team can take several steps to put the interview participants at ease.

First, the team should explicitly state at the outset that the interview results will be kept confidential and that the participants will not be directly quoted in whole or part. The team should also explain the assessment, noting that the results of multiple interviews will be combined and summarized for the final report.

Second, convey a clear message that the purpose of the interview is to obtain a solid local understanding of the needs of the country with respect to the given area of law. Some people are suspicious of Americans and other "outsiders", and even resent the idea that foreign experts are coming in to tell them how to run their countries. Unfortunately, much of this hostility is based on prior dealings with individuals from any number of countries who reinforce these biases. Questions should be structured to honor and draw out local perceived needs and experience in order to capture local demand. In addition, the simple truth is that most local respondents will know more than their interviewers about the specialized topics of the interview; humility will go a long way in producing a better assessment, and a better environment for follow-on work.

Third, some group interviews should be follow-up with separate, individual interviews. From time to time, the diagnostic team will engage a group of three or four respondents in which one provides all the

answers. When these answers appear to be "official" (that is, they depart substantially from the observations provided by other respondents), it may be advisable to invite one or more of the participants for a separate, one-on-one interview to elicit reality-based answers. Even when there is no suggestion of intimidation, separate interviews can be quite helpful due to group dynamics. For example, a court clerk may not feel it is appropriate to share personal views openly in front of a judge, especially in relating problems of court administration. It would be better to interview the judge and clerk separately.

Different legal cultures can also stand in the way of clear communication, especially where terms of art are concerned. Lawyers from common law, civil law, and socialist law traditions may use the same terms with very different underlying meanings. For example, the term "liberty" means freedom *from* law in some cultures, but freedom *under* law in others. To avoid uncertainty and misunderstanding, the interviewer should ask participants to define the terms discussed.

Using Interpreters. It is not usually possible to assemble diagnostic teams in which each legal specialist also speaks the local language. Consequently, interpreters are a necessity. The team will do well to invest time at the outset in their interpreters to ensure quality and understanding. Interpreters should be provided a copy of the indicators, other outlines and questions commonly used.

The diagnostic team should work continually with the same interpreters once their quality is proven. This builds rapport and increases efficiency in the interview process. Few translators will have a substantial background in the legal subject matters being covered, and will perform better if briefed in advance and debriefed after the interviews. Moreover, some of the best anecdotal information comes from interpreters in informal conversations as they have begun to understand the focus and purpose of the work.

USAID missions can generally provide a list of qualified interpreters, and local staff will often know others who are not on the list but have an excellent command of English. It is often possible to find law students who speak English and can translate words as well as concepts more effectively than generalists with no legal background. In one country, the C-LIR team dismissed a certified interpreter in favor of a project driver whose degree in economics and experience in colloquial English were more effective than professional training in translation and interpretation.

D. Expanding the Model

This diagnostic methodology has been used to create new commercial law programs (Croatia) and to redesign and refine USAID mission strategic plans (Albania and Macedonia). It can be used in whole or in part, depending on the needs (and budget) of the user. For example, USAID/Tirana focused on only four areas of law, not seven, to meet their programmatic needs.

The methodology can also be used as a model for drilling deeper in existing areas, or for analyzing new or specialized areas of commercial law not fully covered here, such as real estate or customs law. In Croatia, the initial diagnostic team identified an number of critical areas in need of improvement for the commercial environment, including registries, courts, and access to legal information. New teams used the model to assess each area separately. For example, an analysis of the Commercial Courts started with an examination of the laws governing the courts (the Framework Laws), the courts themselves (Implementing Institutions), the various institutions and organizations that used and supported the courts, including the Judges Association, Bar Association, and court-related services (Supporting Institutions), and the specific demand for reforming the courts. The result was a four-dimensional analysis that tracked the country analysis and enriched the analytical framework for identifying and targeting new areas of assistance.
The C-LIR methodology can also be used as the starting point for analysis of problems of Implementing Institutions. For example, the seven diagnostic assessments conducted already in Europe and Eurasia

have frequently found very weak private sector organizations such as chambers of commerce and professional associations. A program to bolster these groups could use the methodology as a starting point, analyzing legal, institutional and market constraints to growth of such units of civil society.

This same approach can be used to support other initiatives. USAID and other institutions have sponsored a number of "Investors' Roadmap" or "Red Tape" analyses worldwide. Typically, these studies identify areas that have become bottlenecks to trade and investment, and then create plans for eliminating the barriers. The C-LIR methodology provides a useful basis for understanding and attacking the problems that have been identified (even without creating additional scored indicators for the new areas), then designing solutions.

Another use was recently adopted for the C-LIR methodology. USAID has commissioned several assessments in Africa for regional customs programs. The assessments will look at the international, regional, and national framework laws for customs, examine the operations of the customs services, reassess the capacity of the supporting institutions such as freight forwarders, import/export agents, and warehousing services, and determine the demand for change and the capacity of the relevant governments to supply it.

The diagnostic methodology is now being used for baseline assessments for designing and implementing new projects. It might be worthwhile to conduct follow up diagnostic assessments to determine the impact of the project work after several years.

In summary, the diagnostic methodology is both a proven tool that can be used as is, and a conceptual framework that can be used as a model for addressing development issues in other subject matters, disciplines and regions of the world.

VI. USING THE FOUR DIMENSIONS OF THE DIAGNOSTIC METHODOLOGY

In using the methodology, it is helpful to understand the overall structure and approach. The general comments below apply across all technical areas and are supplemented by specific comments under each specific area of commercial law in Section VII.

In some ways, the structure of the methodology follows the chronological history of C-LIR programs. The first generation focused on laws, followed by a second generation of reforms aimed at implementing institutions. The methodology, likewise, begins with Framework Laws and Implementing Institutions, with the third generation addition of Implementing Institutions and the Market for Reform. This logical approach, however, does not necessarily reflect the relative importance of these areas.

As discussed further below, the analysis of the Market for Reform is designed to identify the reasons behind the implementation/enforcement gap. Analysis of laws and institutions provides a snapshot of what is present and missing, but does not necessarily uncover the reasons why these are the way they are. Questions regarding the Market, however, are intended to answer the *how* and *why* of legal and institutional reform. In this sense, the Market dimension is first rather than fourth. Diagnostic teams should keep in mind that the laws of supply and demand are the point of departure for reforms.

A. Framework Laws

Indicators for assessing the Framework Laws are designed to identify and measure the essential elements of each legal regime in conformity with emerging global standards in all facets of the commercial laws. The C-LIR Team used "hornbook law", OECD standards, WTO accession requirements, and various international conventions and cross-cultural legal agreements to distill fundamental requirements for a framework that supports market-oriented growth.

The standards were not necessarily based on an American or European model, but instead were designed from the perspective of investors and business people in developed Western countries. It should be noted that the deliberate bias favors users; that is, the indicators are weighted in favor of what private-sector commercial actors need in order to do business reasonably based on the best practices of the developed West. There are many theoretical arguments regarding the need to adopt, for example, a mechanism for "piercing the corporate veil" in Company Law, but the fact is that the most advanced countries have some version of this doctrine in place, and the diagnostic methodology scores against this standard.

The indicators are not intended to be exhaustive, but exemplary. Highly detailed analysis of specific subareas is more appropriate once a broader need has been identified. Thus, a project to improve competition law, for example, would need to look more closely at issues of vertical and horizontal market integration. The assessment simply determines whether the existing law recognizes the difference.

The definition of Legal Framework is quite ample in order to reduce scoring biases based on preference for different systems. Thus, the Legal Framework includes all relevant laws, whether in one code or several, including implementing regulations for broadly-written laws. As a result, a country whose legal tradition mandates separate commercial and civil codes will not necessarily receive a better score than a country which lumps all commercial and civil provisions into the same code. The ability of a practitioner (including a diagnostic team member) to locate all relevant laws, however, will affect the scores, as will the degree to which separate bodies of law have been harmonized.

B. Implementing Institutions

Analysis of the implementing institutions for each area of law focuses on both theory and practice. On the theoretical side, the diagnostic team examines the laws empowering the institution as well as the organic documents by which it was set up and the internal regulations by which it is supposed to operate. Through this analysis, the team can determine whether it has the legal authority and direction it needs to perform the duties within its mandate. In addition, the functions should be compared with the functions of similar institutions elsewhere: it is possible for a relatively efficient, properly organized institution to be doing the wrong things.

In addition to structure and legal mandate, it is essential to assess the actual operations and performance of the Implementing Institution. This can be done from three angles. First, the diagnostic team should ask officials and employees of the institution how well it is doing its job. Second, the team should interview End Users and officials from other institutions about performance issues. For example, the diagnostic team should evaluate court performance by talking to judges, the Ministry of Justice, and the Bar Association, among others. Third, the team should obtain data and statistics where possible to provide quantitative measures for comparison. Where these are scarce or unreliable, it may be necessary to rely on anecdotal evidence from interview participants, such as how long it takes to prosecute a commercial claim through the courts.

The methodology also seeks to evaluate market-related operations of the Implementing Institutions by examining service orientation and transparency issues. Each set of Implementing Institution indicators asks whether the relevant institution provides information on its functions, rules and procedures to the users and the general public and whether it is "customer-oriented." Just as importantly, the indicators measure the extent to which decision-making is transparent (written and available) and accountable (based on published law or regulations). There is generally a correlation between low scores and a high incidence of End User complaints regarding corruption.

It should be noted that the courts serve as Implementing Institutions for Bankruptcy, Collateral, and Contracts, and as Supporting Institutions for Company Law. This overlap permits some efficiency in a full diagnostic. It is also intended to ensure a more thorough examination of this essential institution. Although the number of indicators related to the courts is relatively small, the importance is enormous. In the seven assessments performed in developing this methodology, courts were extensively examined in the written report; in Croatia, projects were implemented almost immediately to address the weaknesses found during the assessment.

C. Supporting Institutions

The Supporting Institution matrix (Annex 1) illustrates the breadth and depth of institutions and organizations needed for a developed commercial law environment to exist and function effectively. The matrix is not exhaustive, and diagnostic teams will undoubtedly identify other institutions that should be included in any given assessment. These should be used as a starting point, with institutions added and subtracted as needed.

Due to the potential scope of this dimension, the institutions have been categorized into four groups for ease of analysis:

- Government Entities
- Professional Associations
- Specialized Services, and

?? Trade and Special Interest Groups.

Government Entities are those institutions generally funded and run by the government. In some jurisdictions, there may be private sector substitutes, and these should be included in the analysis. Such entities include various agencies and departments involved in the implementation, interpretation, and enforcement of laws. In addition to those listed (bailiffs, courts, customs service, notaries, and registries), an assessment could also include legislative drafting units in parliament, government investment promotion agencies, and numerous others.

Notaries merit special mention for this diagnostic methodology because of their vastly different roles in civil and common law jurisdictions. In the United States, notaries serve primarily to authenticate signatures. They do not receive any formal substantive training and do not need to have a legal background. In civil law traditions, notaries are lawyers with special training and a somewhat exclusive license to perform notarial acts such as approving real estate contracts or company documents prior to registration. Because of this exclusivity, they often act as a legal cartel, sometimes restricting the number of notaries within a given town or region to limit competition, and sometimes fixing prices. Although Americans tend to balk at this system in general, it has functioned effectively for Europe for centuries. Analysis should focus, therefore, on the extent to which notaries act as a constraint to commercial activity, based on price, availability, competency, and services offered. The ultimate arbiters of these issues are the End Users, particularly those with experience in other jurisdictions. They will often be able to pinpoint problems more effectively than the notaries themselves.

Professional Associations focus on two groups: professional services providers such as lawyers and accountants, and professionals who provide information necessary for a well functioning economy such as economists and statisticians. This latter group is especially important for policymaking in trade, investment, and competiton. The lack of self-regulating professional associations of economists and statisticians usually indicates a substantial weakness on the supply side of legal reform.

Lawyers and bar associations are excellent sources of information on the specifics of various areas of law, as well as the overall commercial legal environment. In countries with well-established associations, there may even be sub-divisions and committees dealing with specific practice areas. The diagnostic team should evaluate such associations carefully, however, without assuming that they are similar in nature or function to the bar associations of the U.S. or some other Western nations. In many nations, the bar association is a entity with mandatory membership responsible for licensing lawyers and regulating -- to some extent -- the practice of law. They often provide very limited services, with no real involvement in continuing legal education, training, or advocacy for legal reform.

In many developed countries, lawyers serve as the adjustment mechanism for supply and demand in legal reform. Bar associations monitor gaps and changes in the law based on practical experience, advocate legislative and regulatory amendments, and provide analysis and comment on proposed laws, and assist with or initiate the drafting process. They also serve a watchdog role with the judiciary, documenting needs for reform and assistance. In short, they are an essential point of feedback in the reform process.

Few of the autonomous or semi-autonomous bar associations of developing and transition countries are able to play such a role. The diagnostic team should, therefore, identify whether any of these functions are being provided by other organizations. For example, law faculties sometimes provide continuing legal education, while NGOs monitor the courts (although usually from a human rights angle).

Accountants and their associations offer valuable insights into many areas, but especially Bankruptcy, Company, and Foreign Direct Investment Law, where they represent the principle End Users. Subsidiar-

ies of the large international firms can generally offer useful commentary on comparative issues, such as the use of International Accounting Standards (IAS) or Generally Accepted Accounting Principles (GAAP). The diagnostic team should be careful, however, not to overemphasize any absence of these measures -- very few small companies anywhere in the world use these standards, much less in developing countries. In Albania, for example, accountants noted that the existing accounting law (if enforced), would be sufficient for most accounting needs, and that the market would take care of enforcing IAS by requiring these more expensive standards for public offerings and large commercial loans. Even so, the local standards should approximate international norms.

Specialized Services offer a glimpse into size and health of both the private sector and the market for reform. The relevant services will vary with each subject matter area and from country to country. The underlying premise is that good laws and good implementing institutions are necessary but not sufficient to establish a good Legal Framework -- numerous services are also needed to make things work. Bankruptcy requires appraisers, brokers, auctioneers, repossession agents and liquidators in addition to bailiffs, courts, and accountants.

The presence or absence of these services also suggests much about the level of specialization within a country, with implications for future actions. In some countries, importers and exporters cannot simply use customs brokers, they must hire expeditors to wade through the mire of official and unofficial rules, documents, and off-the-books payments required to do business. Their presence is a sign that the system needs to be overhauled. On the other hand, the absence of company registration services has other implications. In some countries, lawyers spend three or four hours getting company papers stamped at the court house and think nothing of it, while other countries have a thriving service industry to handle such paperwork for the lawyers. This difference could indicate different cost structures, levels of expertise, or simply expectations -- a lack of entrepreneurs to provide lower cost filing services. The diagnostic team should take these issues into account.

Trade and Special Interest Groups, like lawyers associations, are the drivers of reform in most developed countries. These groups give critical mass to their members in advocating change, based on the expressed needs of their members in trying to pursue their specialized commercial interests. Their efforts lead to refinements in the law, increases in economic efficiency, and economic growth.

In countries without mature special interest groups, the process of change is often unduly influenced by a small, non-representative elite. The absence of such groups may suggest the need for a project to support their development as a condition precedent to some forms of legal reform. Indeed, one USAID project in Africa, which preceded the C-LIR work, successfully removed legal constraints to commerce by working with associations to identify the constraints and engage government in a reform program. These broad-based special interests defeated a long-standing export cartel and brought significant economic growth with the legal reforms.[2]

D. The Market for Reform

As noted previously, this diagnostic methodology was created in part to address frustrations from the implementation/enforcement gap after two generations of C-LIR programs had improved laws and institutions but failed to bring the level of change expected. While the first three dimensions look at *what* is present or lacking in the commercial law environment, the fourth looks for *why*.

[2] USAID's Trade and Investment Promotion Support (TIPS) Project for Guinea-Bissau, 1993-98.

The theoretical basis for this dimension comes from institutional economics and can be summarized with the premise that **legal reform, like economic activity, responds to laws of supply and demand.** These market terms need further definition for the C-LIR context. "Demand" can be defined colloquially by the question "who cares?" That is, do any individuals, groups, or entities want reform? If so, do they care enough to do something about it? If not, why not? The demand side of the equation seeks to identify drivers or champions of change, as well as barriers and resistance. (Many changes have short-term winners and losers, with very different perspectives on what is needed.)

"Supply" represents the other half of the equation -- is there anyone who can respond to the demand by providing the changes? If so, how effectively does the supply address the demand? What makes it more or less effective? If not, why not? For purpose s of the C-LIR diagnostic methodology, supply has been assumed to be primarily a function of government. Traditionally, governments control the formal mechanisms for legal and institutional reform.

The market for reform can be compared to a factory. Within a given market (a country), demand exists for different kinds of products (legal reforms, such as the need for secured financing). A factory owner (the government) may decide to begin producing the product using existing equipment (the policy and legislative process) within its factory (the legislature or executive rule making body). To ensure that the product meets demand, the factory owner should conduct market studies among the potential buyers (special interest groups), set up quality controls (implementing institutions), and ensure that there are appropriate commercial actors in place (supporting institutions) to get the product from the factory to the buyers. On the other hand, the buyers can approach the factory owner and ask for changes in the existing product line. Either way, a properly functioning market will connect supply and demand through a dynamic system of information exchange and feedback, with the capacity to refine the product over time in accordance with changing needs.

In many transition countries, the market is in serious trouble or non-existent. The results of the seven diagnostic assessments performed to date show a number of reasonably well designed laws that been very poorly implemented, at best. In other words, the local market has not bought the product (except in Poland). This suggests a "market failure" -- the system is not connecting supply with demand.

The Market Indicators were designed to identify the breakdowns or strong points in the market clearing mechanisms at a number of levels. This is done by examining supply and demand for legal reform, but it does not stop here. The diagnostic looks at the market for improved Framework Laws, improved Implementing Institutions, and improved or new Supporting Institutions, all of which are related.

In addition, both supply and demand are divided into government and private sector analysis in recognition of the complexity of the market. Government can supply reform, but it also can demand change. For example, some legal reforms begin with a visionary leader who understands the need for change before the general population and begins the process from the supply side. Conversely, the private sector demands reforms, but also supplies them when the government fails. For example, arbitration, negotiation, and other mechanisms are sometimes provided by private sector business associations when courts fail to settle disputes effectively.

The Market section of the diagnostic highlights two competing approaches to legal reform. One model favors the efficiency of working with a small group of government officials and outside experts to draft laws in accordance with international standards and have them adopted by parliament with limited review. This approach can result in promulgation of technically sound new legislation within a few months, but seldom is founded upon broad-based understanding and acceptance by the End Users. Such

acceptance is expected to develop over time. These "parachuted" laws are sometimes required as conditions precedent to financial assistance from International Financial Institutions.

Proponents of the other model prefer to start the reform process through collaborative meetings among End Users or government reformers and work slowly through the process of policy deliberation, opening the discussion to as many stakeholders as possible in a dynamic public/private partnership. The reform discussions may begin with identification of issues, followed by preparation of a draft to be negotiated through several versions with extensive End User feedback. The downside of the approach is that it can be very slow, taking several years produce legislation. On the other hand, stakeholder ownership is high and implementation more likely.

Both approaches have their costs and benefits. The C-LIR diagnostic methodology does not evaluate these approaches, but provides insights into the status of acceptance by the "market" and useful areas of intervention. Albania serves as an example of both models.

When Albania came out of its self-imposed isolation in 1991, the West rushed in with assistance. By 1993-94, the country had received an entirely new set of commercial and other laws based on modern European standards. They were adopted under the supply-side, efficiency model, with limited local input. A diagnostic assessment team visited Albania in September 2000 and used the C-LIR indicators to analyze four areas of law -- Bankruptcy, Collateral, Company, and Contract. The team found that the laws themselves were generally quite good, with scores for Framework Laws averaging 85%. Implementation, however, was abysmal. Most Albanian and expatriate legal specialists offered the same assessment, that the laws were fine, they just needed to be used. Scores for Implementing Institutions, Supporting Institutions, and Markets were quite low, at 52%, 33%, and 44%, respectively.

Of particular interest was the Bankruptcy Law. At the time of the assessment, the 1994 law was about to be replaced with a new version. Had the assessment team focused only on the first three dimensions, it might have been possible to conclude that Albania had taken a dynamic approach to bankruptcy reform. An examination of the Market indicators, however, presented a very different picture. The team was able to identify no local demand for the new law, which was replacing one that had never been used. The disuse was attributable to a number of reasons, not least of which was the structure of the economy. Most technical bankruptcies resulting from the collapse of the national pyramid schemes in 1997 were among individuals and small businesses who carried little commercial debt, but rather were unable to repay colleagues and relatives. As a consequence, there was no great outcry for a bankruptcy system, because the debtors operated outside the system. The demand for the new law, therefore, was not a result of recognized needs by the End Users. It was required by a multi-lateral financial institution, the same one that drafted the earlier law, with both laws serving as pre-conditions to financial assistance. The new law is expected to be modern and well crafted, but it is not expected to be utilized any more than the original one until there is a critical mass of commercial lending with a critical mass of defaulting debtors. For some development organizations, the assessment would have resulted in reallocation of technical and financial assistance to more immediate needs.

Collateral Law in Albania has been handled differently. The law is new (passed in January 2000), and the collateral registry has only recently been opened (October 2000). It is therefore not possible to judge implementation at this time. The process, however, suggests that there is a higher probability of success than in other areas. The law was negotiated between the government and private sector stakeholders, such as the commercial banks, resulting in compromises based on local requirements. During the past year, these same stakeholders have worked together to design the registry to meet their mutual needs and capacities. The diagnostic team, however, noted that there was little awareness among most Supporting Institutions or the general public of the significance of the new Collateral Law, despite a potentially large

market for secured financing among farmers, builders and manufacturers. The diagnostic team recommended program assistance to fill this market gap.

A number of the Indicators stand as proxies for more direct measurements. For example, questions regarding specialized sections of professional associations on trade law, for example, uncover the level and sophistication of demand -- specialized sections are generally established only if there is substantial demand for the association to monitor or lobby for trade law issues. Likewise, local universities tend only to offer courses for which there is a demand, and the news media reports on issues where there is public interest. If there is no public or specialized discussion of trade issues, the demand for change may either non-existent, or, more probably, unfocused due to the low level of civil society institutions that can provide an articulate voice for interested individuals.

Most of the Market indicators are identical within each subject matter area, with a few questions based on the peculiarities of the specific legal specialty. This seeming redundancy enables the diagnostic team to look for trends and exceptions by comparing the results after applying the questions within each separate legal context.

The Interviewer should be sensitive to the market distortions brought about by corruption. Although this diagnostic methodology is not designed for in-depth investigation of corruption issues, there are a few specific indicators related to rent-seeking behavior and bribery. For the Market, such practices appear as a distortion in the supply side that can affect the ability of the private sector to press for reform or the public sector to supply it. The diagnostic team is likely to hear of collusive dealing, conflicts of interest related to investments by officials in industries that would be damaged by reforms, and petty bribery at among functionaries of Implementing Institutions and government Supporting Institutions. The diagnostic team should discuss these findings with the agency sponsoring the assessment (presumably the local USAID mission), and determine whether such findings should be included in the report or stated in a side memorandum, depending on local sensitive and political considerations.

Without question, the Market for Legal Reform dimension of the diagnostic methodology is the newest tool in the C-LIR toolbox. It is likely to be controversial, and is sure to be refined still more from its present form as it is increasingly used and better understood. This, however, is one of the great strengths of the C-LIR methodology, that it can continually be revised and adapted to meet changing needs and demands.

VII. THE DIAGNOSTIC INDICATORS

A. Bankruptcy

During the past ten years, Bankruptcy Law has been one of the principle areas of legal reform efforts in developing and transition countries. While many Western donor groups have offered help, several international financia l institutions have gone beyond recommendations to insistence on the passage of modern bankruptcy laws as a pre-condition to financial assistance. Thailand, for example, adopted a new Bankruptcy Law several years ago in order to obtain ongoing assistance from foreign lenders.

Despite this attention, Bankruptcy Law is one of the least understood areas of legal reform covered by the C-LIR diagnostic assessment. Among most End Users (including policy makers as well as bankrupt businesses), the concept is tainted with perceptions of failure, wrong-doing, and disgrace. Some countries attempt to insure that economic actors will not go bankrupt by making it very difficult for any but the very wealthy to incorporate, assuming that the state should not permit entry to those who might fail. Deeply ingrained cultural attitudes are sometimes at odds with the idea of "forgiving" debtor companies

who cannot pay their bills, so that punitive measures are sought as part of the bankruptcy package. The fact that bankruptcy has been used extensively in Russia and some other former Soviet countries to pillage companies and hide from creditors makes it even harder for legal reformers, who understand the need for an orderly market exit mechanism for failed businesses, to bring about effective implementation.

No matter what the local perceptions, Bankruptcy Law is critical to the proper functioning of a market-oriented economy, especially one in which entrepreneurship is encouraged and risk-taking is necessary.

The World Bank has recently undertaken an initiative to develop principles and guidelines for effective insolvency and debtor creditor regimes, with an emphasis on emerging markets, noting that insolvency systems serve as a disciplinary mechanism in both the corporate and commercial sectors of a society For example, under many bankruptcy laws, conduct and transactions that took place at a time prior to the commencement of former bankruptcy proceedings can be reexamined by the court. Similarly, company management may sometimes be personally liable for debts incurred by the company under certain circumstance.

A well-designed and effective system of insolvency law provides a valuable incentive for maintaining high standards of corporate governance, including the maintenance of fiscal discipline by company management. The manner in which creditors and debtors are treated under a given bankruptcy law, furthermore, influences perceptions of the corporate sector and corporate finance more generally and the extent to which parties are willing to extend credit to corporate entities initially and to commence bankruptcy proceedings in the event of a company's failure.

The legal framework must also be compatible with the general commercial legal framework in order for it to be effective. For example, the relationship between the collateral law and the bankruptcy law is important vis a vis the treatment of secured creditors during a bankruptcy proceeding. The procedural rules for administering bankruptcy proceedings are also crucial to a well functioning bankruptcy regime.

The C-LIR bankruptcy section is specialized. Ideally, the Interviewer will be a bankruptcy practitioner or have some degree of familiarity with comparative bankruptcy law and procedure. Terminology may vary in the target country, so that the Interviewer should be familiar with relevant variations. As an efficiency matter, the Interviewer may also have responsibility for the collateral section of the diagnostic to better determine whether the treatment of secured lenders in bankruptcy is consistent with the collateral law.

It will be important for the Interviewer to meet with as many judges and bankruptcy administrators as possible in order to get a proper sense of how the courts are handling existing cases. The more specific examples that can be provided by the interviewees, the more useful the diagnostic report will be. In addition to court personnel and administrators, the Interviewer should speak with lawyers for creditors and insolvent enterprises. Additionally, discussion with management from an insolvent enterprise would also provide useful insight into the treatment of corporate debtors within the jurisdiction. Longer interviews may be required to ensure enough time to obtain detailed descriptions of bankruptcy procedure (i.e., discussing everything from commencing proceedings to how claims are filed and challenged to a discussion of creditor's committees and reorganization proceedings).

An insolvency system will inevitably reflect a country's policy choice (e.g., on issues or whether to protect debtors or creditors, treatment of employees, payment of different kinds of claims), its social and cultural background and its legal and institutional history. The Interviewer should, whenever possible, determine what policy choices are reflected in the target country's law. For example, is it pro creditor? Are employee's rights valued highly? Does the government hesitate to place a company in liquidation? And if so, why?

1. Legal Framework

Framework indicators focus on five different areas. First comes the issue of whether there is in fact a coherent **bankruptcy law** in place (a "code" in some jurisdictions), whether the definitions are clear, and whether the law is in harmony with other relevant laws. Many countries that have recently changed course toward greater individual economic freedoms and market orientation end up with a patchwork of laws coming from different traditions and time periods. In addition, poorly coordinated foreign assistance can result in related laws based on different national models with inherent conflicts. It is important, therefore, to examine collateral and mortgage laws, especially to determine possible conflicts in priorities and claims. Commercial lenders can usually assist with this information, as they are most sensitive to the risks from contradictory laws.

The second group of indicators focuses on **commencement of proceedings**. A number of interests are implicated here. First, the issue of certainty is important -- defining the rules of the game for when a debtor may seek bankruptcy protection or be forced into insolvency or reorganization proceedings. The threat of bankruptcy is sometimes used as a form of legalized extortion, or a way of bypassing slower court proceedings. International best practices use cash-flow and balance-sheet tests as triggering events, provide sanctions for the misuse of bankruptcy proceedings, and limit the amount of judicial discretion in determining whether bankruptcy is appropriate. A clear definition of insolvency is essential given the importance of any trigger mechanism that puts a legal entity into insolvency. If the trigger is pulled too early, the action may have detrimental effect for a debtor trying to save its business; if the trigger is pulled too late, creditor rights may be impaired because the debtor's assets may be depleted

One weakness in the bankruptcy system of a number of countries is that it cannot be invoked in a timely manner, or by enough parties. Delays (from court discretion, long-proceedings, or unclear triggering devices) can permit the bankruptcy estate to become so depleted that there is little left to satisfy creditors. The diagnostic team should double-check the indicator questions against actual practices. Another weakness or gap sometimes comes from confusion or unnecessary costs in the claims procedure itself, so that priorities and secured properties are not clearly identified. A failure in this area ultimately results in lower lending -- banks and others will lower their risks by issuing fewer secured loans and by raising the cost of the loan to cover the costs and risks of uncertainty.

Another area of frequent misunderstanding is in the use of bankruptcy as a protective device to permit ailing enterprises to reorganize. A separate group of indicators focuses on the existence and quality of **reorganization** provisions and the way in which creditors and debtors can reach an agreement to reorganize the company as an alternative to liquidation. A workable bankruptcy law should have an alternative to liquidation. The law should cover, among other things, the following types of issues: (i) commencement of a reorganization procedure, (ii) identity of parties who can commence a reorganization procedure, (iii) extent of the "stay" during negotiation of the reorganization plan; (iv) management role during negotiations; (v) route to transfer to liquidation at any time; (vi) time limits; (vii) voting on the reorganization plan and (vii) implementation of the reorganization plan. Again, the questions focus on the ease, efficiency and fairness of the reorganization process.

The Interviewer should pay also special attention to the level of creditor support needed to approve reorganization plan. The reorganization options in industrialized economics' bankruptcy systems normally require two-thirds or a majority of creditors to approve a recognition plan. The term "reorganization" may have a more or less expansive meaning in different countries (for example in some jurisdictions sale of the assets as a going concern is considered reorganization).

Some jurisdictions have dual majority requirement, counting votes by number and claim amount. The dual requirement protects large claims from being subjected to a plan favored by only small claimholders, while it protects large groups of small claimholders from the wishes of holders of large claims.

Finally, the Framework Law indicators deal with the most frequently used section of the bankruptcy system in most of the countries studied -- **liquidation**. The indicators focus on the administration of the estate, including the liability of the Administrator for breach of fiduciary duties (a very common complaint in many emerging market economies). In addition, a healthy bankruptcy framework clearly enumerates voidable and fraudulent transfers. The diagnostic team may need to review the criminal code also to determine whether fraudulent transfers are handled as economic crimes in addition to any treatment under the Bankruptcy Law itself.

An administrator is an independent person whose role is to supervise or manage bankruptcy proceedings. Given the importance of the role of the administrator, the bankruptcy law needs to set forth clearly the powers and responsibilities of the administrator. The law should also set forth the minimum qualifications for the administrator (possibly through a licensing regime). Some commentators have noted that it is preferable for a court to appoint an administrator and for the law to set forth the requirements for when an administrator can be dismissed. The law should also provide a transparent and easy to understand method for remunerating the administrator. This is a safeguard against corruption or conflicts of interest.

It is important that the administrator possess the ability to review certain types of suspect transactions entered into by a bankruptcy company prior to the commencement of liquidation proceedings. The bankruptcy law should enumerate the types of transactions that the administrator may review and declare void

Another subset of the liquidation questions involves the priority of claims among creditors. In order to attract foreign direct investment and to implement an efficient and effective bankruptcy regime, a prior toy among creditors needs to be set forth and respected. Secured creditors should be compensated according to the value of their secured claim. Administrative costs, however, such as the payment of the administrator and other court costs, may be paid before secured creditors are compensated in some circumstances. Certain claims such as taxes or payments to employees should be kept at the lowest level possible as such priority can undermine the investment climate by decreasing lender's confidence in secured lending.

The Interviewer should be careful to note whether there are any differences legally or in practice between the treatment of different classes of creditors, such as discrimination against foreign creditors in favor of local debtors. An otherwise healthy law can break down badly when it improperly discriminates among parties.

2. Implementing Institutions

For Bankruptcy Law, the Implementing Institution is generally a bankruptcy court or a specialized section of another court. In some cases, the diagnostic may find that courts of general jurisdiction can hear any bankruptcy claim. In such cases, they will also tend to find that these non-specialized courts do not do a very good job.

The diagnostic indicators are similar to those under the Contract Law section of methodology, but should be examined in the limited context of bankruptcy. After separately treating each area, however, the diagnostic team should compare the results and look for any trends or variations. For example, bankruptcy courts frequently receive specialized technical assistance from the donor community, and therefore may

have better administrative and case management systems than courts of general jurisdiction, or all may suffer from the same ailments. Either way, the implications for court reform projects are affected.

The bankruptcy interviewer will note the usual dual focus in this section between theory and practice. Judges, administrators, or relevant ministry officials may have a very positive few of the structure and function of the courts, while the business community is highly dissatisfied. This is not necessarily a matter of self-protective behavior by those with a vested interest in a positive review -- there may be substantial improvements underway, but not enough to satisfy the End Users. The interviewer should, therefore, try to capture trends as well as time-bound observations for discussion in the narrative text.

2. Implementing Institutions

For Bankruptcy Law, there are two Implementing Institutions: courts and administrators. Each is examined in terms of organization and operations.

Courts: Organization. The capacity of the courts to handle the often complex commercial issues involved in bankruptcy cases is the principle concern of this section. The adequacy of courts is a significant factor that influences, for example, the length of time for bankruptcy proceedings. Special focus should be given to the training of all court personnel involved in bankruptcy matters: judges, clerks, bailiffs, and others. The bankruptcy law should also provide ample room for the exercise of judicial discretion in order to develop a more workable bankruptcy court system.

Bankruptcy is often considered a specialized area of legal practice. Consequently, there may (or may not) be judges who specialize in bankruptcy procedure in the target country. The Interviewer should try and speak to judges who handle bankruptcy cases. The Interviewer should ask the judges and other court personnel, what efforts have been made (by the government, the bar or by donor agencies) to educate and train the judiciary in bankruptcy law and procedure.

Courts: Operations. The operations indicators ask how well the courts are handling bankruptcy cases. To the extent that the courts have not been well organized or equipped to handle bankruptcy as a specialized area, this will affect the outcome of the operations section as well.

The questions are, by their nature, more subjective and opinion based. It will be important for the Interviewer to speak with End Users (creditors, lawyers, accountants, debtors), bankruptcy administrators, and judges before trying to score this section. Some questions will be more challenging to score. For example, Indicator 8 is a broad question about whether procedures for commencing and closure of a proceeding are transparent and consistently applied. The Interviewer, when scoring such questions, should include in the narrative the reason for the score provided.

The Interviewer should also try and get specific examples from the interviewees to support any conclusions. For example, is there evidence of quite contradictory practice between judges? Do companies with a government shareholder get treated differently than others? Are proceedings unnecessarily delayed by due to lack of court capacity to handle cases?

The latter half of the questions focus on perceptions of the business community. The business community may include bankers, foreign investors, minority shareholders, domestic business owners (large scale as well as smaller proprietors), securities professionals, accountants, and lawyers. Another important set of questions focus on the role of the courts in providing information to creditors and the public. Are bankruptcy petitions and other filings easily accessible? Are records computerized?

Administrators: Organization. It is very important for the Interviewer to speak with bankruptcy administrators as part of the interview schedule. Bankruptcy administrators are vital to a well functioning bankruptcy system. Administrators handle the day to day issues of overseeing the bankrupt company during liquidation, dealing with creditors and their claims, auditing, and investigating the company's financial affairs. These tasks are difficult and require some level of professional expertise with respect to business matters.

Unlike judges, however, in many transition countries, bankruptcy administrators constitute a new class of professionals. Hence, their training, oversight and certification is key to developing a well-trained and respected group of professionals. Ideally, some sort of licensing or certification system should be in place and administered by the government or some private sector professional body. Certification should be based on objective standards such as type of profession, years involved with relevant work (e.g., as a lawyer, accountant or manager) and perhaps demonstration of skill through coursework and a licensing exam.

The organization questions ask whether administrators have sufficient authority, staffing and other resources in carry out their jobs effectively. The questions also ask whether there are mechanisms in place for oversight of administrators by the courts and/or by the government.

Administrators: Operations. The operations questions examine how effectively administrators are carrying out their duties. These questions look at whether there is, in fact, a sufficient number of qualified administrators working within the bankruptcy system. Additionally, the questions ask administers as well as End Users and judges to evaluate the extent to which administrators have used powers delegated to them and whether they have done so effectively. Administrators may be vested with authority, but the authority needs to be used in order for the bankruptcy process to be viewed as efficient and effective.

3. Supporting Institutions

There are a potpourri of **government entities** that provide supporting services to the courts and administrators. Several questions focus on the role of government enforcement agents (e.g., bailiffs) who must execute judgments against a debtor's estate (e.g., on behalf of secured creditors). One question asks whether parties resort to extra-judicial mechanisms in order to enforce debtors against a bankruptcy party. To the extent that parties work outside of the court system, this means that the perception of the legal system and its effectiveness needs to be improved. Additional questions focus on the role of notaries, registrars (company and collateral), and the prosecutor.

For **professional associations** , indicators look for the existence of specialized sections dealing with bankruptcy issues, and the level and nature of their activities. For many countries, there is a great need for initial and follow-up education in new or changing laws. Some countries do not have any formal program, but depend heavily on donor initiative in these areas. The Interviewer should ascertain whether any professional associations currently provide such services or would be interested in doing so.

Another question examines the role of professional accountants in providing valuation of a debtor's estate, specifically, whether they use generally accepted accounting principles or some other internationally recognized standard when valuing property. This is critical to providing the administrator, the court, and creditors with realistic assessments of the value of a company or commercial enterprise. Answers to this question may indicate opportunities for program assistance.

As the demand for bankruptcy proceedings increases, it is expected that the private sector will respond with an increasing number of **specialized services** that promote the quality and efficiency of the bank-

ruptcy process. Are there competent appraisal firms, turnaround consultants, and others available through the courts or individually? Are there legal repossession agents to assist secured creditors in obtaining their collatersal? Or is the enforcement gap so severe that creditors resort to illegal mechanisms for self-help? The existence of credit agencies would also be of interest for the assessment, especially if they track and provide information on bankrupt individuals and entities.

The **trade and special interest group** indicators focus on the presence of associations (e.g., chambers of commerce, particular business sectors) who encourage conformity of bankruptcy law and practice with international standards. The questions also ask whether such groups have worked with international organizations to achieve such conformity with international practice. Additionally, in order to encourage secured lending and increased investment, such groups ideally will be advocating for the interests of secured creditors.

The Interviewer should also try and ask businesspersons who are creditors how familiar they are with the bankruptcy law and procedures. In many jurisdictions, lawyers and judges receive training from NGOs or international financial institutions. Creditors, however, are never properly informed about the mechanics of a new bankruptcy law. It would be interesting, therefore, to learn how creditors become aware of the legal requirements for bankruptcy proceedings. It may be that their lack of awareness may be a reason for their reluctance to commence proceedings. Similarly, creditors may have some interesting ideas for creditor education initiatives.

The last indicator asks about use of bankruptcy proceedings instead of turning to extralegal measures as an indicator of public confidence. This should not be confused with statistics on growth in bankruptcy filings, which may only indicate the economic situation in recent years. Even so, it would be useful for the Interviewer to obtain statistics on bankruptcy cases.

4. Market for an Efficient Bankruptcy System

Market for Improved Laws. The diagnostic team should be aware that bankruptcy is essentially the unwelcome handmaiden of commercial credit. Without a substantial number of commercial loans, including secured and unsecured, the need for a market exit mechanism is not particularly great. Most informal creditors who loan within the context of an intimate society generally do not resort to formal collection procedures. In Albania, most credit is between friends, family, and colleagues; even with the virtual bankruptcy of the entire country in 1997 due to the collapse of national pyramid schemes, only one or two bankruptcy cases were ever filed. This market tends to develop as a consequence of a vibrant commercial credit market, so it is useful for Interviewers to be aware of these relationships.

This relationship not only affects the level of demand, but the nature of those demanding. The Interviews should expect the greatest to demand to come from the banking and secured-creditor community (such as automobile or farm-equipment vendors who sell on credit). Lawyers and accountants will hold a wealth of information on the quality of the bankruptcy law, but may not be well connected to the underlying demand. The diagnostic team should, therefore, be certain to cover the market questions with private sector groups and individuals.

Bankruptcy demand indicators also delve into the participation by the private sector in the legislative process. The extent to which comment and participate, however, may relate to the transparency and openness of the legislative process more generally. In other words, in some jurisdictions parties have little opportunity to actively comment on draft legislation, to participate in hearings or to communicate at all with legislators and ministers. To the extent that there appears to be a lack of organization and involvement of these groups (hence a lack of "demand"), the Interviewer should try and determine the reasons.

The supply questions focus on the government's responsiveness as to private sector groups advocating improvement in the bankruptcy sector. Has the government encouraged, for example, a privatization plan? Has the government taken action against potential abuses of creditor's rights (e.g., by prosecuting management involved in fraudulent transfers or other fraudulent activity with respect to insolvent companies)? Additionally, and more importantly, has the government made efforts to communicate with and to work with business groups – including those representing creditors and lenders (financial institutions). The supply questions (similar to the demand questions) ask more broadly about the government's efforts to make the legislative process an open one where feedback and input is sought from stakeholders prior to enactment of laws.

The Interviewer should also ask End Users and government officials how closely the government monitors the financial stability of various enterprises, number of companies that are technically insolvent, and what measures the government has taken to encourage reorganization or liquidation of insolvent entities. The Interviewer should also ask, to what extent bankruptcy reform or placement of more companies into bankruptcy, has been something required or requested by international financial institutions.

The supply questions also asked more subjective questions of End Users. The questions ask for the perceptions of the business sand professional communities as to the relative stability and effectiveness of the existing bankruptcy law and practice. The questions ask to what extent that the business and professional communities feels that the law is responsive to their main needs and also easily understood. As mentioned above, it is imperative for the Interviewer to speak with business leaders and to creditors who have been involved in the bankruptcy process. Creditor perceptions of the adequacy of the law (and their awareness of the law) is an important measure of how effective the law is. If the law is comprehensive, for example, but rarely utilized by creditors, then the system may not be functioning well.

Market for Effective Implementing Institutions. The demand questions ask to what extent the government is seriously monitoring the role of courts and administrators and working towards improving the quality of services provided. The questions also ask whether End Users demand the services of the courts, in effect, by using them. A lack of proceedings may mean a lack of demand for the court's services as currently constituted, but may also mean a healthy economy or an undeveloped commercial credit industry, as previously noted.

The supply indicators focus on perceptions of the End Users on how effectively the courts and administrators handle bankruptcy cases. As with other segments of the diagnostic, the emphasis is on fairness, openness, transparency and efficiency. Reasons should be solicited for any complaints about these issues, preferably with specific examples cited. For example, are administrators perceived as corrupt or rather as merely inexperienced? Are judges viewed as unpredictable? Alternatively, is it just a lack of information (i.e., of access to decisions and records) that creates a perception of inconsistency? There is also a question as to the pricing of bankruptcy procedures. To the extent that costs are high they may tip the cost/benefit analysis of whether to pursue bad debt through the courts.

Market for Improved Supporting Institutions. This is a short section which asks to what extent there is a perceived need for Supporting Institutions to provide services in areas such as valuation, administration, accountancy, consulting, etc and if so, whether there is a sufficient supply of qualified service providers. To the extent that Interviewees identify any deficiencies here, the Interviewer should ask how an unfilled need can be met or how the qualifications of service providers can be improve (i.e., through training, licensing, limitation to firms rather than individuals). Lack of such services may not represent a low demand, but rather an immature market in which the supply does not yet meet the demand.

B. Collateral

The Collateral section of the C-LIR diagnostic methodology focuses on the legal system as it relates to pledges and security interests in different asset classes. The term "collateral" as used in the diagnostic includes "the [l]aws procedures, and institutions designed to facilitate commerce by promoting transparency, predictability and simplicity in creating, identifying and extinguishing security interests in assets." The ability to use security interests in movable property is essential to a vibrant market economy. Commerce needs inexpensive capital in order to thrive and lending that is secured by a pledge of property is one of the most economical means of securing financing. Secured lending, in theory, reduces a creditor's risk since it provides the creditor with a second source of payment if the debtor defaults.

Collateral Law is intended to facilitate commerce by reducing the cost of lending by reducing risk through a standardized system of secured lending. Through the act of pledging property to the creditor, a secured loan or transaction provides creditors with security in the event that a borrower defaults on debt. The creditor can, under certain circumstances, sell or take possession of the pledged property if the borrower defaults on a loan. A more standardized and predictable system for creating a security interest/pledge should stimulate greater lending activity. Collateral Law also provides for certain rules governing relationships between a debtor and a creditor. This preserves the rights of some creditors (i.e., secured creditors) against the rights of others in the event of a debtor's bankruptcy. The process of "registering" a pledge or security interest protects the rights of a creditor in the event that the borrower's property is pledged multiple times.

The market for secured credit depends in large part upon an effective Collateral Law and system for registering pledges in many types of property, including movable property, inventory, grain, equipment, and even intangibles. To the extent that a common law lawyer is conducting the diagnostic, he or she may want to become familiar with the civil law system and various concepts concerning pledges or secured transactions. A useful reference is the Model Law on Secured Transactions (and accompanying commentary) produced by the European Bank for Reconstruction and Development.[3]

The Collateral section focuses on security interests in many types of property, not just real estate or immovables such as buildings. There may not be a specific law on mortgages in place. If there is, it would be useful to review this law as well.

The source of a new or amended Collateral Law is also important. The Interviewer should try to determine the basis for the existing legislation (e.g., is it based on a civil law jurisdiction's approach? Was it drafted with foreign technical assistance and if so, from whom?). This will help the Interviewer understand the underlying features or biases inherent in the framework law. The Interviewer should try and speak with persons directly involved in the drafting or advisory process. These may include government officials, local or foreign academics, and representatives from IFIs or other donor agencies.

The diagnostic team should meet with various members of business community for their views on the adequacy and effectiveness of the law. Bankers are essential, as are vendors of property subject to pledges, such as automobile sellers, agricultural equipment suppliers, and household appliance retailers.

1. Legal Framework

[3] The Model Law on Secured Transactions, EBRD, 1994 located at http://www.ebrd.com/english/st.htm

The Legal Framework indicators include questions designed to ascertain the comprehensiveness of Collateral Law in a given country. This section is divided into four segments.

Forms of Collateral. This first segment examines the scope of the Collateral Law. In highly developed secured lending systems, there is a wide range of property subject to pledge, from consumer goods to commercial warehouse receipts. Sometimes the law explicitly lists the types of pledges permitted. However, this may also be based on court interpretation, legal commentary or custom and practice. Hence, the basic law and regulations may not be sufficient to determine the extent of coverage, which must be obtained through interview participants. The Interviewer should be prepared to run through the entire list of forms of collateral with the respondents. It is quite useful to have a translation of the types of collateral, as some of these phrases may not seem familiar in English, and to ask the respondents simply to check off all of those that apply.

Establishment and Registration. The indicators focus on whether the Framework Law provides clear procedures for creating a pledge/security interest. To the extent, for example, that notarization or registration of the pledge is required, the law should spell out what is required to make the pledge legally enforceable in a court of competent jurisdiction and/or capable of being registered. The diagnostic team should determine whether the requirements are documented and readily available, and whether the published requirements are the same as those demanded in practice.

Enforcement Procedures. The enforcement indicators focus on process and procedure. The Interviewer must ascertain how clearly the Framework Law sets forth procedures for pledges to enforce their pledges both by means of self help and with court assistance. These questions do not ask how well the law works in practice (i.e., whether creditors can truly enforce pledges or sell collateral to satisfy a debt). Rather, these questions simply ask whether the law contains procedures that provide for enforcement.
Definition of Implementing Institutions. For purposes of the diagnostic, the collateral or pledge registry is the principle Implementing Institution would be a collateral registry. Courts are also Implementing Institutions in that they enforce the underlying pledge contract, and are examined in the next section. The focus here, however, is on the extent to which the Framework Law establishes the registry and defines its role.

The registry, which may be run by the government or by a private entity, is the organ responsible for registering all pledges and for providing creditors and other members of the public with efficient access to records in order to determine whether certain collateral is subject to prior pledges. In many jurisdictions in the countries where the C-LIR diagnostic has been conducted, collateral registries were new phenomena. Some jurisdictions may have a framework law in place but not yet have regulations that create or empower a functioning registry. The registry indicators detail whether the framework or related laws call for a registry and provide sufficient detail as to the functions and duties of the registry.

2. Implementing Institutions

These indicators focus on both the collateral registry and the courts as Implementing Institutions. The registry, as the main Implementing Institution, is examined more fully. (Courts are covered in greater detail under Contract Law.)

Collateral Registry: Organization. The first set of indicators asks is structural, assessing the formal establishment, including mandate and staffing. To score this section, the Interviewer will need to meet with staff from the collateral registry as well with, perhaps, government officials associated with the registry. They will be able to answer some of the detailed questions about the operation of the registry and should provide organic documents and any organigrams showing the internal structure. It is best to give advance

notice of these needs, but some respondents will not be comfortable in providing documentation until they have met the interviewer. (The concept of public access is not thoroughly accepted in many countries).

These questions do not necessarily result in a clear picture of the registration system, so the Interviewer should also ask respondents to describe the registry and its most important features. Their narrative descriptions can form the basis for description in the text of the diagnostic report.

Collateral Registry: Operations. Unlike the "organization" indicators on structural issues, the "operations" questions are designed to assess how well the registry is actually run, focusing primarily on the registration process. The secondary service of the registry is the provision of information/records to users. There is, therefore, a secondary set of indicators on access to records. Both, however, are issues regarding the quality of service provided to the End Users.

There are some factual questions about whether copies of the Collateral Law and regulations are made available, or if rejected applications are accompanied by a written explanation for the rejection. Most of the questions, however, focus on the subjective perceptions of End Users. How fair, transparent and efficient is the registration system? Is the system free from corruption? These questions can certainly be asked of registry personnel, but are aimed at End Users as a means of assessing the effectiveness of the system.

This is another area in which the Interviewer may want to ask the End Users to describe the process of registering in a step-by-step manner. To the extent that registration can occur in locations throughout the country, the Interviewer might speak with /end Users from different locations, to get a feel for regional variation (if any).

Statistics or data will also help the Interviewer understand how the effectiveness of the registry, as well as the extent to which the Collateral Law is being used in the economy. How many agreements have been registered to date? What is the frequency? Are the numbers increasing? How long does it take to register a pledge? The registrar is the most likely source for that data, although banks and other lenders may also keep statistics. The Interviewer is trying to assess whether the existence of a registry and registration system has increased the amount of secured credit available. In other words, the diagnostic attempts to assess the link between a well functioning collateral registry and the market for secured credit.

Additionally, the Interviewer might ask End Users whether they know (either personally or through the colleagues or even the news) about registrations than have been declined or rejected. If so, they might describe the reasons for the rejection. Similarly, if there are any instances where specific collateral had been previously pledged, and the registry provided or failed to provide notice to subsequent creditors, this information will also be useful. Another question to ask the End User is what features of the process could be improved and how. This may provide useful information for the market analysis and for brainstorming about next steps in the collateral area.

Role of the Courts as Implementing Institutions. Court indicators relate to their authority to deal with collateral disputes and to enforce a collateral holder's rights in the event of a default. The first question asks whether courts are empowered to hear disputes against the collateral registrar based on the premise that there should be some way for End Users to challenge the authority of the registrar. This may be the courts, or some sort of administrative tribunal. Courts should also have the authority to hear claims for execution on the collateral for non-payment of a loan and also to enjoin creditors from inappropriately resorting to self help (e.g., selling collateral without proper procedures). These indicators help determine

whether authority exists and is sufficient; several more questions focus on whether the End Users feel that the courts are using this authority effectively.

The Interviewer should ask business End Users and lawyers about their experiences with the courts. Have there been active cases relating to collateral? Have parties gone to court to execute on collateral when a borrower has defaulted on payment? If so, what has been the experience? How long has it taken? Asking the interviewees for concrete examples will help them to base their answers on more tangible criteria than just providing an impression of the courts. The Interviewer should also try to meet with a judge or judges who have handled collateral cases. (Note that this is an area where overlapping subject areas can provide some procedural efficiencies for the diagnostic team. If different team members are handling Contract and Collateral, the member responsible for Contract should have substantial interviews with judges. Rather than set up separate meetings for Collateral Law questions, the Contract Interviewer should be prepared to cover this area.)

3. Supporting Institutions

There are numerous supporting institutions in the collateral area.

The first category includes **government entities**. For collateral, these may include notaries (if they are required to notarize registration documents or collateral agreements) and government enforcement agents (e.g., bailiffs). The role of enforcement agents is crucial, as they assist creditors in executing on their collateral agreements.

The second category is **professional associations**. The questions ask whether accountants use generally accepted accounting principles when valuing collateral. This is important, because if collateral is over valued, then it is not serving as an effective security mechanism in the market for secured credit. The Interviewer needs to speak with an accountant, bankers and other commercial lenders about this issue.

This section also asks about the role of lawyers with respect to Collateral Law. The Interviewer should try to find out if there is part of the bar or a bar association that focuses on issues of commercial lending and Collateral Law and practice. In some countries, there may be a general business law section of the bar association that holds training and continuing legal education for its members.

The third category relates to **specialized services**. These indicators pertain to the ability of non-government entities to provide services that facilitate the market for secured credit. The questions ask, for example, whether banks or other business entities offer collateral filing or registration services for a free, which is common in advanced collateral jurisdictions. There are also questions about the role of trade or professional associations in creating standardized forms (which may be in use by proprietary filing and registration services). Standardized forms tend to lower overall transaction costs and increase efficiency.

Universities (especially law or business faculties) may also play an important role in writing commentary about the Collateral Law and process and in instructing new generations of lawyers about the law. This important for refining the system over time.

There may be additional services that have been created that speed up or enhance the government registration system. For example, the filing and registration companies or banks may offer services whereby they search the registry for pre-existing liens on property. In some countries, credit rating services search the registry to advise secured and unsecured creditors about the creditworthiness of individuals. Additionally, law firms may not be the only entities who prepare registration materials. To the extent that a larger number of entities provide assistance on a competitive basis with creation of the

larger number of entities provide assistance on a competitive basis with creation of the agreement or registration, this is also interesting information.

The fourth category is **trade and special interest groups**. The focus of these indicators is primarily on the End Users (both as debtors and creditors) and their involvement in both using and improving the secured lending system. For example, there may be an organization of bankers or lenders whose views are important. The views of farmers, small businesses as well as foreign investors are also important in assessing the effectiveness of the Collateral Law structure.

The questions ask to what extent these organizations are involved in the ongoing use and development of the system. This includes more general involvement by civil society, such as a business press or media coverage. Not all relevant organizations are specifically mentioned, so the Interviewer may wish to seek out representatives of other groups, such as manufacturers or farmers associations, and to capture additional information in the narrative report.

4. Market for a Modern Collateral Law System

The indicators for the Market segment measure the "demand" from End Users for Collateral Law reform and the "supply" from the government in terms of legislative change or reform to processes in response to the demand. For many countries, the Market is quite weak because there is little history or understanding of non-possessory pledges, despite the need for secured credit. For that matter, few in the U.S. legal community are aware of the connection between economic development and collateral lending. The diagnostic team should be on the look-out for this knowledge gap and potential project interventions to bridge the gap. Open-ended questions regarding local need, in addition to the indicator questions, can produce a wealth of useful information.

Market for Improved Collateral Laws. This segment focuses on the legislative aspects of the Market, and the degree to which government and private sector actors are working (together or separately) to improve and adapt the Legal Framework to local needs and international norms. If the target country has neither a modern Collateral Law nor a centralized registry, it is especially important to focus on the demand questions. Are government and private sector entities trying to push for change? If the Collateral Law is unreformed in the country, the Interviewer should focus on the size and nature of the demand from both the government actors (e.g., politicians) and the private sector for reform.

If the law has been recently reformed, the Interviewer should focus on how demand affected the reform process. For example, who seemed to influence the government's decisions to reform the Collateral Law? Did the driving force come from donor agencies, the private sector, the government, or some combination?

The questions on private sector address two principle questions. First, is demand strong enough that specialized groups (special committees of a merchants' association, for example) have been formed to address needs? Second, is anyone from the private sector actively engaging government to bring about change? If not, is this because the market is satisfied with the quality and level of supply, or because too few people understand how collateral law works?

The supply indicators seek information on the reform environment, the reform process, and, perhaps most importantly, the effectiveness of government in meeting demand from the End Users' perspective. The Interviewer. An effective response includes not only legislative reform but also dissemination of information about amendments, inclusion of stakeholders in the legislative process and an active legislative agenda. The private sector supply questions are really perception questions asking whether End Users

perceive the Collateral Law framework to be efficient, effective and transparent. For purposes of designing new programs of assistance, it can be very useful to ask respondents who express dissatisfaction for suggestions on how the system could be improved.

Market for Implementing Institutions. These indicators focus primarily on the collateral registration system. The questions attempt to determine the demand for an effective and well functioning collateral registry. First, the questions ask whether any government officials or donor agencies have been championing the creation or improvement of a collateral registry. Te questions also ask whether mechanisms are in place for the government to properly monitor and assess the performance of the registry. It is not sufficient for the government to create a registry. There need to be means for evaluating the implementation of the registry and for making revisions as needed/responding to continued demand from the private sector.

The private sector "demand" questions focus on customer satisfaction. Do End Users utilize the services of the registry? If not, are alternative private sector services available. For example, if it is time consuming to search the registry, have private competitors developed services to search the registry for a free?

The "supply" questions focus first and foremost on the responsiveness of the registry. Does the registry respond to customer need and provide useful services and information (such as a written explanation of its decisions)? Does it provide an opportunity for user feedback? More generally, does it have an internal program for improving its services and also for reporting on its performance to the government? The Interviewer might ask if it has any sort of annual operation plan and performance goals, targets or objectives.

The supply questions, obviously, require interviewing the collateral registry staff and potentially employees in the government ministry that has oversight of the registry. To the extent that registry employees believe that they are responsive to user needs; the Interviewer should ask for examples. Also, the Interviewer might ask what changes have been made to the registration process and what prompted such changes (e.g., user demand? Self-assessment and identification of problem areas? Donor agency request? Government requirement?). The Interviewer might also ask where the registry staff could use additional assistance or guidance from the government or from End Users in order to improve their performance.

Market for Supporting Institutions. This section asks about whether there has been a demand among End Users for specialized services offered by the private sector. For example, have professional associations or trade/special interest groups stepped forward to offer service such as registration and filing services, collateral valuation, etc? To the extent that there are such services on offer, is there more than one service provider in order to promote competition? Is the supply of such services viewed a sufficient? If the answer is no, again the Interviewer should press for what services are deficient.

C. Company

Company Law plays a crucial role in market economies by providing a sound legal environment for limited liability and corporate finance. Company Law establishes guidelines for the internal organization of companies and for corporate governance. Along with securities legislation, it is designed to protect outside investors, creditors, and the public by specifying minimum requirements for capital and mandating publication of information about the company. It also aims to encourage entrepreneurship by setting limits on the liability of investors. Company Law provides the rules for the way in which companies must operate both internally and externally.

The C-LIR Company Law questions focus on the ability of persons to form joint stock companies and the rights of shareholders within such a company. The questions also focus on corporate governance and the duties and responsibilities of management to shareholders. Comparative corporate governance has become an important focus with respect to law and development. The Organization for Economic Cooperation and Development (OECD) has recently developed a set of principles for corporate governance. The OECD principles emphasize the core principles of fairness transparency, accountability and responsibility. The five main subject areas covered include the rights of shareholders, equitable treatment of shareholders, the role of stakeholders, disclosure and transparency and the responsibility of the board. As part of the preamble the OECD notes:

> One key element in improving economic efficiency is corporate governance, which involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently.[4]

The Company Law question were based in part on the core principles set forth in the OECD principles. The questions assess the legal, institutional and regulatory frameworks in place in a country with an eye towards seeing whether they facilitate good corporate governance and Company Law practice. The OECD Principles, along with other similar guidance and codes of conduct, focus on key structures that must be in place and well functioning for development of a good governance environment.[5] The existence of a good governance environment should facilitate stronger investment activity.

More than one government institution may be involved in the implementation and enforcement of Company Law. For example, in addition to the courts, a national securities commission may have a role with respect to minority shareholder protections or enforcement actions against certain publicly-traded companies. Consequently, it is important for the interview schedule to include representatives from all government entities that work to enforce the Company Law and related legislation. Shareholder protections in the event of a takeover may not be found in the framework law but in related laws (e.g., securities laws).

Additionally, the Company Law in the given jurisdiction may have been recently revised. It will be useful to find out who drafted the law and what foreign advisors (if any) assisted with the drafting process. There are various models upon which new Company Laws are often drafted, including the German model, the U.S. model (often based on New York or Delaware's Company Law). Within a given region, moreover, a certain framework may serve as a model for neighboring countries. Russia's Company Law, for example, influenced the reform process on neighboring countries such as Uzbekistan. Understanding the origins of the law will help the Interviewer to understand the underlying principles behind the law. If a revision process is contemplated in the future, it will be useful to speak with the persons who have championed the reform process as well as the potential stakeholders who will be involved in the revision process.

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[4] Excerpt from OECD Principles of Corporate Governance SG/CG(99)5 (April OECD Paris, April 1999) located at http://www.oecd.org/daf/governance/principles.htm

[5] See for example, European Bank for Reconstruction & Development, Sound Business Standards and Corporate Practices: A Set of Guidelines (September 1997) available at EBRD website: http://www.ebrd.org.

Many of the indicators relate specific to joint stock companies, especially with regard to shareholder rights. The diagnostic team should not view this as a bias in favor of this form, and should be certain to look careful at the make-up of the corporate community. In many of the countries assessed, the majority of companies will be sole proprietors, partnerships, or other simple limited liability companies. The more complex forms of corporate governance tend to increase as the economy matures, and may be limited to very few examples. In Albania, most joint stock companies were foreign enterprises or banks, with very few locally owned.

1. Legal Framework

The Legal Framework indicators address several discrete topic areas related to the formation of a joint stock company and the roles, rights and responsibilities of shareholders, management and directories.

Incorporation, formation and mechanics. The first set of questions focuses on how a joint stock company can be created and registered such that it has legal status in a jurisdiction. The ease with which a person can form a company is seen as a priority as it facilitates the ability of entities to raise capital by borrowing and issuing shares while limiting liability. Capital requirements and requirements regarding charters and bylaws should be kept to a minimum. Furthermore, the actual process of registering a company (via the courts, a specific company registrar or other government agency) should be easy, fast and also unbiased (i.e., free from corruption or favoritism), based on published standards and guidelines.

The questions in this section are primarily factual in nature, although they involve some subjective assessment (e.g., as to whether registration procedure is fair). It will be important to interview both the persons who register companies (judges, registrars, etc) as well as End Users (lawyers and businesspersons) to see how their perceptions of the process vary (if at all). In addition, it is useful to ask judges whether they feel that these registrations are an appropriate use of their time. Many judges are overburdened with ministerial functions better handled by a clerk, so that dissatisfaction in this area may provide the impetus for reform.

Shareholder Rights. The second set of framework questions focuses on the role of shareholders within Company Law. The questions ask about the extent to which the Company Law or other relevant laws provide explicit rights for shareholders. Some of the terms used in this section may seem technical and may not readily translate. For example, the question as to whether shareholders may easily alienate shares without undue encumbrance may need to be explained to interviewees. Similarly, the concept of a super majority-voting requirement (i.e., the need for a two-thirds majority or the equivalent) should simply be spelled out during questioning – perhaps by way of an example. Another concept that may be new or novel within a jurisdiction is voting by proxy. Again, examples help with the interview process.

It will be useful for the Interviewer to have reviewed the relevant legislation and to have identified what appear to be shareholder rights as enumerated in the laws. This should be compared with the responses offered by interviewees. Whenever there appears to be a discrepancy, it is important to ask the respondents about initial findings, including explicit questions about whether any of the findings are inaccurate.

Creditor Rights. This section is comprised of two questions and focuses on the role of creditors in the event of fraud or collusion or other fraudulent acts within a company. The concept of piercing the corporate veil was originally a common law concept (which has been adopted in Germany and elsewhere) and may need to be explained more fully to the End Users. Answers to these questions may shed light on problems of using the corporate form to defraud creditors by transferring corporate assets to individuals prior to declaring bankruptcy.

Officers, Directors and Governance. This section focuses on how well the law defines the roles and duties of senior management and the board of directors within a company. It also asks about the external mechanisms required by law to ensure proper governance and management accountability, such as the role of external auditors in monitoring a company and certification of its financial statements. For the most part, these requirements should be spelled out in the Company Law. However, director liabilities may be described more broadly in the Civil or Commercial Code rather than in the Company Law. The diagnostic team should be cognizant of this possibility and ask interviewees whether any of these requirements may come from other laws

Implementing Institutions. These indicators are virtually identical to those elsewhere. The issue is whether the Framework Law defines the Implementing Institutions and requires them to act in accordance with law through written documentation. The emphasis is on accountability and transparency. The implementing regulations of the relevant institution may have similar requirements.

2. Implementing Institutions

These questions focus on the main government entities responsible for the creation of limited liability companies and for monitoring their compliance with the framework law. The principal institution for this assessment is the company registrar (or the functional equivalent) in registering companies and the role of courts in implementing Company Law and in resolving disputes arising under the Company Law. Questions relating to antitrust or competition mattes (e.g., question slating to merger control and approval) are encompassed in the Competition section of the diagnostic. The only related questions in this section are questions about shareholder rights in the event of a takeover.

Company Registrar – Organization. This segment focuses on the role of the company registrar or the equivalent in creation of limited liability companies and amendment of corporate documents. In some instances, the relevant entity may be the courts rather than a registrar. The organizational questions focus on the registrar's resources, staff, and infrastructure, but are subjective and require more than a factual assessment. Words such as "clearly," "sufficient," and "adequate" indicate that the scores will be based on subjective considerations. The scores should reflect the opinion of the diagnostic team, however, based on international best practices and experience. In addition, the Interviewer is asked to assess whether the perceptions held by the registrar staff, government officials and End Users is relatively similar. It will be important to interview representatives from these three groups in an effort to gain an understanding of whether views are shared or are quite disparate.

Company Registrar – Operations. The second segment focuses on how well the company registrar operates in practice. The primary function is described as the registration process. The questions here ask about the efficiency, fairness and transparency of the registration process. The fewer the impediments, the greater the speed, and the more information provided to applicants, the higher the score for this segment. The secondary function of the registrar is described as maintenance of public records and information on company formation. These questions are aimed at how well the registrar provides information on company registrations and Company Law issues, and the sufficiency of public access to records.

Courts. The courts are envisaged as the primary site for resolution of lawsuits against companies, including suits by shareholders, creditors, and individuals (e.g., employees). This may not be explicitly set forth in the Company Law. Therefore, it will be helpful for the Interviewer to not only ask if such lawsuits are possible but also to ask what the legal basis is for bringing such actions. The Interviewer might also ask if any such suits have occurred. In some instances, shareholder litigation may be non-existent or a new concept introduced by foreign investors who are shareholders. The questions also emphasize End

User satisfaction as a reality check by looking at the perceptions of the courts from perspective of the business community. This includes perceptions about how well the courts enforce arbitral awards.

3. Supporting Institutions

Government Entities. Initial indicators focus on the government institutions that support the work of the company registrar and the courts. Once again (as with other areas such as Collateral and Contract Law), the role of a notary may be important to an efficient company formation and registration process. The Interviewer should speak to local notaries as well as End Users.

As an efficiency matter, the diagnostic team may want to appoint one person to examine the role of notaries through the various subject matter areas. The notarial functions pervade commercial transactions in the European tradition, so that there are issues of Contract, Collateral, and FDI as well, all with a similar focus on adequacy of services. The C-LIR Diagnostic Teams who designed the methodology assigned one member to cover notaries, with input from the other member.s

The questions also ask about the existence and quality of additional registrars in fields such as copyrights, trademarks and domains (although some of these registration functions may be combined with the company registrar function). End Users, for example, need to know whether a certain company name has already been utilized and legally registered. Additionally, End Users often need to know whether a company's potential business idea (e.g., a potential patent) is something that has previously been registered. Access to such information affects investment and business decisions. Similarly, the courts or other government agency need to maintain up to date and easily accessible records on company bankruptcies, judgments and liquidations so that creditors and investors can assess the financial stability of an enterprise. The diagnostic team should determine the level and quality of information available to the business community and to the general public.

Professional Associations. The emphasis of this section is on the role of lawyers and accountants. The questions here are similar to questions in other segments of the diagnostic. The main issue for accountants is whether they regularly use generally accepted accounting principles or some other internationally recognized accounting standard when auditing the financial statements of companies. Valuation and the use of appropriate standards are vital to a well functioning market economy.

The other important issue is whether lawyers and accountants regularly encourage legislative reform in the area of Company Law. As those closest to the legal issues, they are well positioned to take the lead in improving the system. Finally, the questions ask whether lawyers, accountants and other professionals (e.g., notaries if private sector, securities depositaries,) are satisfied with the services provided by the company registrar. This is a useful question for asking interviewees about ways in which the registration process could be improved.

Specialized Services. This segment focuses on the role of the private sector in providing auxiliary services that enhance the operation of public companies in a market economy. For example, the questions ask to what extent banks, lawyers and other entities may offer company registration services. As the service industry develops, there should even be competing service providers. The questions also ask about the role of the private sector with respect to publishing articles and holding conferences related to Company Law and corporate finance. Universities are another sector that may provide services in terms of commentary on the Legal Framework.

Another group of indicators looks at the role of a stock exchange and professional brokers and securities registrars/depositories in creating a well functioning public market for securities. In the absence of a well

functioning securities market, a well-structured joint stock Company Law has less significance. Investors will invest in public companies to the extent that their shares will increase in value through trading on a well function stock market. Low scores in this area should be analyzed in the context of corporate demographics. If there are relatively few public companies, then the diagnostic team may reasonably expect to find under-developed securities services until demand for them matures. On the other hand, poor scores in country with a large number of public companies points to a different set of problems.

As mentioned previously, it is essential for the Interviewer to be familiar with the securities laws of the target country. In addition, the Interviewer should ask whether there are any specific criminal laws that are relevant for capital markets offenses such as insider dealing or market manipulation. A government securities commission may have enforcement authority, or this may be delegated to the state prosecutor. The scope of authority for the stock exchange and the securities commission authority should be ascertained through the interview process.

The Interviewer should meet with representatives from the Stock Exchange and Securities Commission (if one exists) as well as with brokers. Foreign investors and representatives of donor agencies will also be able to share their experiences with capital markets – as potential shareholders in the jurisdiction. They will be able to compare and contrast their experiences in other markets as well. The Interviewer should be sure to ask for concrete examples of the types of enforcement or supervisory actions taken by the securities regulator with respect to publicly held companies. Statistics on the volume of trading and the number of listings is also useful data.

Although there are no specific questions on these issues, the diagnostic team should also try and ascertain what level of disclosure is required of public companies as a condition of their shares being listed and traded on the domestic stock exchange. Questions on disclosure and transparency are important -- not only with respect to shareholders – but with respect to members of the public (i.e., potential investors). Listing requirements, for example and also the rules for public offerings, are good indicia of how transparent the market is for publicly traded securities. The Interviewer might try and obtain copies of prospectuses to determine actual practices.

Trade and Special Interest Groups. Questions here focus on the role of bankers associations, chambers of commerce, foreign investor associations, and the media in monitoring Company Law developments, educating their membership, and working for effective reform in the Company Law area. There is also an interesting question as to how senior management and directors are educated about principles of good corporate governance. Are there associations in place for chief executives, for example? Are there institutes or think tanks focused on issues of corporate governance? How are managers trained and educated about corporate governance? These are important issues for understanding the current and future health of the Company Law environment. If possible, it would be interesting to speak to the heads of some of the major companies to determine what level of expertise they have and how they familiarize themselves with Company Law and legal requirements.

4. Market for Efficient Company Law

This last set of questions focuses on demand for an efficient and modern Company Law that promotes corporate finance and investment and the corresponding supply of such a framework and environment.

Market for Improved Laws. The demand indicators highlight the role of government officials, professionals (lawyers, accountants), and business or trade groups (including bankers, securities professionals), and universities to not only keep abreast of Company Law issues, but to lobby for change and to participate in the legal reform process.

Supply questions look at the way in which the government has responded to private sector request for change, and whether the private sector has stepped in to fill any gaps in government services. The questions are quite broad in their coverage of the government's ability to respond -- not only by drafting new laws but also in monitoring their implementation and in continually assessing the need for improvement.

One important stand-alone question is about efforts taken by the government (and perhaps the courts) to protect minority shareholders (who are often foreign investors) from majority shareholder abuse of the dominant position within a company. Government oversight might take the form of actions within the courts with respect to shareholder litigation, legislative reform (in terms of granting shareholders more rights), or government enforcement and supervision through the securities regulator. Other questions focus on whether the government has been proactive in involving the business community in the reform process.

The supply questions related to the private sector are based on perceptions of satisfaction with the regulatory environment? Do stakeholders feel that the law is applied in a fair and transparent manner? Is the law predictable, as evidenced by consistent court rulings or commentary from the government or scholars? Have minority shareholders found the law conducive to their interests and protection of their rights? It will be useful to speak to foreign investors (or investment funds) as well local businesspersons about their perceptions of the corporate sector in the country.

Market for Effective Implementing Institutions. These questions focus primarily on the demand for an efficient and well functioning company registrar. With respect to government involvement, the main issue is whether the government retains demands compliance from above through an active oversight role. Is the registrar accountable? To whom? How is performance measured? Have any improvements been made?

For the private sector, the issue is to what extent the business community utilizes the services of the registrar or uses a third-party alternative for the services if there is a market failure (e.g., if it takes too long to search the company registry, have private companies filled the void by offering such a service on behalf of the public)? Have private sector entities taken publicly available information and computerized it or otherwise published it (e.g., in business directories, marketing lists, etc) as a means of making access to information faster and easier? The presence of private sector services or extensive use of government services demonstrates a high level of demand. The lack of such services, however, does not prove the converse, but could indicate a lack of entrepreneurial culture, insufficient knowledge about the potential for private sector involvement, or simply the fact the environment is in an early stage of natural evolution toward more sophisticated service offerings.

The supply questions focus on the responsiveness of the registrar. Does the registrar have any plans or means for assessing its performance and for making improvements? Do End Users have an opportunity to provide feedback? Does a registrar consider itself accountable to members of the public for its decisions? The notion of customer service is an important facet of the process. The Interviewer ideally will speak to both End Users as well as members of the registrar staff about how performance goals, objectives, and success (or perceived failure) of the registration process are measured. Of course, computerization is an important part of many government processes. The Interviewer should ascertain to what extent the registrar is computerized and what plans exist to update and modernize the registry through the use of information technology.

End Users are also asked to provide their opinions about how well the registrar is run. Are End Users satisfied? If not, what would they change and how? The Interviewer should obtain the cost schedule for

registration and other services (e.g., searching the company database, copying records) and also ask to what extent the fees defray the operating costs of the registrar. To the extent that End Users desire change, the Interviewer might ask to what extent they are prepared to pay increased fees for improved services.

Market for Supporting Institutions. The last set of questions focuses on the private sector demand and supply for supporting services. Is there a demand for professional or trade associations such as bar associations, trade groups (e.g., chambers of commerce, banners associations, pension fund groups, etc)? is there demand within these groups for committees or sections dedicated to Company Law issues? If there is a demand, has the demand been met?

To the extent that the private sector has had problems organizing itself, the Interviewer might ask what about impediments to better organization among professionals or businesspersons, such as the lack of funds, time, or qualified professionals. (Newly emerging professions such as bankers or certified accountants may not have the critical mass to support an association yet.) Are there any specific examples of groups that have been successful at gaining membership, lobbying the government and providing education to the membership on Company Law issues? USAID has a strong background in association development, so these questions can be the basis for designing new initiatives.

D. Competition

In a contest to determine which area of commercial law is least understood and appreciated by the general public, Competition Law would certainly finish near the top. Whereas Bankruptcy Law often elicits strong moral feelings regarding failure or disgrace, and Collateral Law is not consciously connected to economic growth by most non-professionals (and many legal professionals), Competition Law often appears counter-intuitive and contradictory to some of the strongest desires and convictions of the general public and the business community.

Former socialist and mercantilist countries sometimes have very little appreciation for the role of competition, especially when there is economic upheaval underway as a result of macro-economic restructuring. Laborers, consumers, and merchants openly long for the "good old days" of fixed prices and wages, deploring the uncertainty of shifting costs and negotiated salaries. Moreover, nationalist sentiments in re-emerging countries that had been dominated by an ethnically different controlling central government often war against the idea that foreigners should be allowed to compete freely with domestic enterprises. Recent protests at meetings of the World Trade Organization and the International Monetary Fund make it clear that the idea of international competition is not universally accepted. For many policymakers and End Users, Competition Law is truly a foreign concept.

1. Framework Law

The diagnostic indicators for Competition Law focus primarily on definitions of prohibited behavior and the enforcement and sanctions for violations of the law. The diagnostic team should be well versed in international standards in order to determine the adequacy of the definitions of the local law. Actual interpretation of these definitions must also be examined, to ensure that the implementing institutions and professional community are applying the law correctly.

The interviewer should also be aware that many anti-competitive laws are disguised as entry restrictions to a given area of economic activity. Thus, the Competition Law may prohibit cartels while a licensing authority protects them by keeping newcomers out. For example, the laws of one African country re-

quired exporters to own a minimum amount of warehouse space in order to export the principle cash crop. Only six entities had such space, and very few potential exporters had the means or reasons for such an investment. USAID helped to remove the export cartel by working with business and government to show that the restriction was unnecessary. A simple review of the laws is unlikely to expose these arrangements, so an interviewer should be attentive to the various requirements for licensing, permits, and deposits (especially by foreigners) that my be exacted from new entrants. (This issue is expressly covered by question 19 regarding unnecessary licensing requirements.)

For enforcement, the indicators include questions regarding both the initiators and targets of procedures. The law should permit a broad range of entities to seek termination of prohibited practices, including consumers, competitors, and the government itself. At the same time, the government should be subject to such complaints -- in Mongolia, USAID found in the early 1990s that the most serious anti-competitive behavior came from the government, not the private sector. Privatization of former state monopolies may just be a shift in ownership from public to private sector monopoly, unless the state actively enforces the anti-trust laws.

There are appropriate exceptions to the competition law, of which the most important perhaps is intellectual property. A number of countries do not recognize patents, copyrights, and other intellectual property rights, or do not expressly exempt such rights from the Competition Law. There are numerous historical and philosophical reasons for this, but the fact is that such countries become investment backwaters with little foreign investment and little intellectual property creation. For the diagnostic team, there are two issues: whether the country protects intellectual property, and, if not, why not. The second question helps to understand the market for reform.

Natural monopolies, another exception to the general rule against monopolistic behavior, have become increasingly controversial. All countries have permitted some monopolies such as electricity providers, water companies, and telephone companies to operate subject to regulation to keep them from abusing their monopoly positions. Recently, however, the change in technology has brought into question the propriety of monopolies for telephone (including internet service providers) even in very small markets. In larger markets (such as the U.S.), some of the sacrosanct monopolies of the state have been opened to competition. The role of the diagnostic team in this environment is not to determine whether a given industry within the country should be permitted to continue as a natural monopoly, but to identify whether such monopolies exist, and, if so, whether the law provides adequately for their regulation.

Several indicators address government practices, including the misuse of licensing to protect incumbents, as already noted. The questions also ask whether the law limits the ability of central and local authorities to establish and support monopolies, a significant problem in some regions, and whether the law promotes open procurement in government contracting. The procurement issue has received increasing attention in recent years, and should be covered more thoroughly in the narrative discussion of the report.

2. Implementing Institutions

Indicators for the Implementing Institution follow those for other areas of law, focusing on the organization and structure of the relevant entities. There are various names and approaches for competition agencies, ranging from the Anti-Monopoly Committee in Kazakhstan to the Cartel Administration and Monopoly Commission in Macedonia. The diagnostic team should be aware that some countries may divide various aspects of the law between different agencies (as in Macedonia), or that the mandate of an institution may not cover the entire range of the law. The diagnostic team must determine how and to what extent enforcement of the law has been established by the various bodies.

The interviewer should pay special attention to the structure and staffing of the Implementing Institutions. Many countries lack qualified personnel in this very sophisticated area of analysis, or do not pay enough to keep the qualified personnel who are available. Also, the Implementing Institution may not be sufficiently independent, or may be too overburdened with bureaucratic requirements to bring about any meaningful enforcement. In one country studied, the otherwise competent Competition Agency was hamstrung by a requirement that all enforcement proceedings go through a highly dysfunctional court system. The only successes of the highly frustrated director had come through negotiating with the targeted companies to change their behavior to avoid prosecution.

For private or state-owned natural monopolies, there should be a different Implementing Institution in the form an independent regulator. A number of countries are attempting to increase bureaucratic efficiency through multi-sector regulators, or may have separate entities for each area. The assessment team should be careful to identify all relevant institutions.

Finally, it should be noted that the courts act in part as an Implementing Institution (although some have argued that they should be considered Supporting Institutions). Courts interpret and apply the law, and as already noted, can either advance or hinder the implementation of Competition Law.

3. Supporting Institutions

For **government entities** the greatest setback to Competition Law often comes through those with veto power over licenses and approvals, as already noted. Others should be examined, especially those promoting investment, to determine whether or to what extent they also promote competition. Some foreign investors have been known to ask for legal or regulatory changes that would hinder local or other international competitors as a prerequisite for bringing a large investment into the country. (Diagnostic assessments in former colonies of Western nations are likely to encounter such practices among investors from the former colonial power.) This unexpected change in the rules is damaging to competition, investment, and the economy generally.

The **professional associations** involved with Competition Law are generally those of lawyers and economists. Statisticians may also be important, but some emerging market economies do not yet have private sector suppliers of statistics, in which case the diagnostic team should for a statistics unit within the government entities. The interviewer will often be able to obtain the highest quality information from lawyers, including those involved in the Implementing Institution, and the counsel to companies who have defended or brought procedures. If the local bar association has a specialized competition section, the interviewer can save much time by obtaining information and additional contacts through them.

Economists are important for their analytic work in supporting or defending positions on anti-trust and competition issues. The diagnostic team should determine whether the supply of economists is sufficient not only to assist the implementing institutions, but also to assist policymakers in understanding and supporting the need for Competition Law and to lobby for its implementation. The interviewer should also determine whether the local universities, as **specialized services,** are producing a sufficient number and quality of new economists or whether the country is dependent on outside resources for its economic expertise.

The interviewer should also engage service providers from the import and export community to identify behaviors and attitudes affecting competition, especially competition with foreigners. Freight forwarders and importers will be able to identify discriminatory practices, as well as discriminatory policies. If the diagnostic team is divided so that different members are covering Trade and Competition, then the Trade researcher should be careful to ask Competition questions and debrief the Competition researcher later.

Trade and special interest groups can be critical to the success or failure of Commercial Law implementation, and not all will be supportive. Chambers of commerce, in some developing countries, often represent a small elite and act as the principal headquarters for cartels and anti-competitive agreements. In some places, they are pseudo-public institutions, with government support and sponsorship, and thus are not a separate interest group with a clear voice for market-oriented change. The more important question is not whether there is a chamber of commerce, but whether there is a critical mass of other business associations to compete with the chamber in the public arena. USAID has shown in several projects that development of numerous competing associations (producers, small merchants, shippers, manufacturers, consumers, foreign investors) is essential to combat anti-competitive behaviors and practices, and to keep the public debate honest. What Adam Smith noted so many years ago is still true -- "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices." (The Wealth of Nations, vol. 1, bk. 1, ch. 10, 1776.)

Because of this natural tendency among special interest groups to fix conditions of trade to their advantage, consumer protection organizations can be one of the most important voices for competition. Many consumer rights NGOs have been started or supported with outside help, and the leaders are often keenly aware of their importance in creating or maintaining a competitive environment. Even so, the interviewer should be aware that in unstable economies, there is much confusion between causes and symptoms, so that even consumer groups may lobby for stable conditions through government sponsored price-fixing and mandatory indexation. This has a serious impact on the market for reform.

4. The Market for an Open, Competitive Economy

As already noted, there can be substantial confusion over the nature and need for a highly competitive economy. Formerly state run companies, even when privatized, are not in a position to compete with many start-ups or with foreign suppliers of the same product or service. If the public is focusing on the "injustice" of lost jobs, there may very well be an anti-competitive preference, especially among elected officials whose constituency stands to suffer factory closings or job losses due to competition. Few understand that competition *eventually* creates more jobs, but do know that the first impact is often the failure of previously well known (and highly inefficient) businesses that cannot compete.

In determining underlying attitudes in the market for (and against) reform, the researcher should determine the level of organization among small entrepreneurs and members of the informal sector. These domestic businesses are the ones most likely to lobby for change, as the old-line service providers tend to try to keep new entrants out of the market. Informal merchants, who tend to operate in the extralegal environment due to the burdens of formalization, are often a target of the formal sector -- the informal merchants not only compete, they tend to defeat attempts at vertical integration in the distribution of imported goods.

Even among these newcomers to the market, there can be some interesting non-competitive attitudes. For example, researchers found in one country that small merchants named lowering prices as an unfair business practice. The interviewer should be certain to ask all respondents to name unfair or undesired business practices to determine to the extent of understanding of this area of law.

The most common area of anti-competitive behaviors and attitudes cuts through all levels of local enterprises: foreigners. Although these issues are covered in part by the Foreign Direct Investment and Trade

sections of the diagnostic methodology, the existence and level of discrimination against outsiders also has implications for understanding Competition Law and the competing forces in the policy arena. The diagnostic team found in Croatia that many policy makers and interest groups who generally understood the value of competition were willing to discriminate against foreign access to the market because of massive growing unemployment and bankruptcy among local businesses. While some may consider this short-sighted, it is a powerful motivation for delaying open competition.

E. Contract

Assessing Contract Law can be very challenging, because the topic is potentially so expansive. This area of law is the underlying foundation for essentially all commercial activity, which requires the existence of enforceable agreements. For the diagnostic methodology, the emphasis is on the process of requirements for contract formation and the mechanisms for enforcing contracts in the event of disputes or failure to perform. More concisely, the scope of this section is the legal and institutional framework for the creation, interpretation and enforcement of commercial obligations between two or more parties.

As background material, the member of the diagnostic team responsible for Contract Law should prepare by studying the relevant law, which may include a civil code or law on obligations,[6] the commercial code, and any relevant legislation that deals with specific types of contracts (e.g., concessions laws, lending, or mortgage laws). The Code of Civil Procedure will be the principle source of legislation for enforcement issues connected with litigation. These laws will often state whether arbitration or other alternative dispute mechanisms are permissible, but the Interviewer will probably need to ask local specialists to provide other law on this matter, such as treaties or implementing regulations for treaties. To better ascertain the country's commitment to international norms in these areas, the diagnostic team syould verify whether the country is a signatory to any international agreements such as the United Nations Convention on the International Sale of Goods and on the Enforcement of Foreign Arbitral Awards.

Once in country, an interviewer should also try to obtain copies of contracts or standardized agreements. A review of relevant contract clauses will help the interviewer to assess more quickly the types of provisions that are common to commercial contracts. One might also look at contracts between foreign entities and domestic persons as well as contracts concluded between domestic parties only.

It is very important that person conducting the assessment also speak to persons knowledgeable about enforcement of judgments and remedies, including bailiffs. This will enable fuller understanding of the success that parties may or may not have with the court system.

1. Legal Framework

The Legal Framework questions are designed to assess the current state of contract law in the test country by focusing on issues of contract formation, enforcement and remedies. In addition, several questions address the definition of Implementing and Supporting Institutions.

Contract formation. The first set of indicators looks for structure and consistency in the law and conformity with international standards. Although there may be a number of laws dealing with some aspect or subset of contracts, there should be one principle body (the Civil Code, for example) that sets forth the general contract rules. Often there are separate laws or special code chapters covering land ownership and secured transactions, as well as separate company code. These should be in concert with the basic

[6] Lawyers from common law jurisdictions should be aware that the main body Contract Law is often found in various different bodies of law, but primarily in the Civil Code or Law of Obligations.

law -- that is, any restrictions on formation and freedom of contract should lower the overall score and be noted in the narrative text.

Market-oriented Contract Law in robust economies provides for substantial freedom of contract. This freedom includes the broad ability of parties (individuals, companies, and government agencies) to enter into commercial transactions without any special approvals or authorizations, other than standard limitations based on age and or mental capacity of individuals. The diagnostic team should also be aware of any restrictions on the ability of women to enter into contracts on their own behalf that do not apply equally to men. Some countries may still characterize women as minors under the law. The team does not need to comment on the underlying cultural reasons for such a division, but should reflect this exception to freedom of contract in both the scores and narrative text.

Many types of contract are subject to special requirements, such as notarization. The Interviewer can expect to find such requirements expressly stated in the law, but should ask local contract specialists whether there are others which have been developed in practice or through other laws and regulations. The Interviewer should also ascertain the impact of compliance or non-compliance on enforceability and legality. In some countries, for example, notarization is simply a matter of evidence in proving the identity of parties to a contract, while in others, the contract is not legal or enforceable unless it is notarized. In addition, the Interviewer should differentiate between forms required by law and by practice. For example, New York is famous for its standardized forms ("Blumberg forms") that have become so common in practice between parties that banks will not accept a power of attorney in a mortgage transaction unless it is on the correct Blumberg form. Similar practices in the country being studied should be noted in the text, but should not affect the score because these are not required by law.

Several of the indicators deal with issues of flexibility and freedom with respect to interpretation and content of contracts. The diagnostic team should determine whether the law expressly permits parties to vary standardized terms such as remedies and choices of law and forum. Must the contract apply local law only, or can the parties choose to subject themselves to relevant foreign laws? Must they submit themselves to the jurisdiction of a certain forum within the country, or may they also choose a forum more convenient for them or one outside the country? The Interviewer should expect to find some criteria for reasonableness, but should look to see determine through reading the law and through interviews whether such freedoms exist. (These freedoms may be especially important to foreign investors, or between parties in evolving areas of law who wish to use internationally established laws instead of local provisions.) In addition, the issue of trade usage and industry standards is primarily one of evidence -- do the courts respect such choices and support the freedom of the parties to define the terms of their contracts, or do they seek to impose some form of legal certainty that interferes with industry standards.

Remedies and Enforcement. This section has some interesting features from a comparative law standpoint. The first issue, of course, is whether the Framework Law or any specialized laws (e.g., real estate) adequately provide for appropriate remedies. The diagnostic team should verify through interviews whether local practice limits or expands the remedies found in the law, and whether such courts will enforce them effectively and without discrimination with respect to parties.

The Interviewer should also attempt to understand the legal culture regarding "gaps" in the law. Some legal traditions operate on the premise that anything not expressly prohibited by law is permitted. Others reverse the presumption and prohibit everything that is not expressly permitted. This second approach is much more restrictive and generally has a negative impact on investment and commercial activity. The Interviewer should note this aspect in the body of the narrative, as well provide an appropriate score in Indicator 12b.

Definitions of Implementing and Supporting Institutions. Questions regarding the Implementing Institution focus on the courts and are similar to those found in all other sections of the diagnostic. Contract, however, is the only area of law where the Framework Law section looks for definitions of Supporting Institutions. The institution under investigation is that of notaries, which play such a key role in most civil law traditions. Additional questions on the function and effectiveness of notaries follow in the Supporting Institution section; the focus here is on whether the Framework Law clearly defines their role.

Other Comments. In an effort to understand the theoretical basis for the framework law, the interviewer should try to speak with law professors as well as with lawyers and judges. Very often revisions to the civil code or a new law will have been drafted with substantial assistance from a professor in the target country. Their insight and perspective on the drafting process will be invaluable. To the extent that there have been legislative reforms in the area of contract and obligations, the interviewer might also ask what changes were discarded or unsuccessful and why.

Most of the questions in the Legal Framework section are questions that will have either a "Yes" or a "No" answer. For example, is the country a signatory to the CISG? The answer should be either Yes or No with a corresponding score of "10" for "0." There can be variations within these binary questions, however. For example, a country may have adopted the principles within an international agreement without becoming a signatory to the agreement. In such a case, the Interviewer has the discretion to award a modified score, but should explain the scoring in the text.

In some instances, however, the questions are more normative or subjective. For example, another question states: "The Civil Code substantially conforms to international standards with respect to . . . .intangible property". The phrase "substantially conforms" suggests that there will be room for degrees of conformity. Here, the interviewer will have to use his or her discretion based on responses from End Users. The diagnostic team of may wish to use an incremental approach of perhaps 0 3, 5, 8 and 10 points for questions where there may be answers that vary in terms of degree. It is useful for the team to agree before conducting the diagnostic as to acceptable increments to use when scoring. Additionally, the Interviewer should have information ready to explain why a score falls between the 0 and the 10. Having a consistent scale for answers where varying points will be awarded is important for all parts of the assessment.

2. Implementing Institutions

The main implementing institutions for contracts are the courts and the judiciary. These questions focus on whether the courts are sufficiently staffed and financed in order to operate effectively, and whether they do, in practice, appear to resolve disputes. It is very important for the interviewer to speak to as many judges as possible – from each level of the court systems (e.g., court of first instance, appellate court, supreme court if possible; commercial courts) in an effort to gain an understanding of the workings of the court system. Government officials from the ministry that supervises the courts (most likely the Ministry of Justice) will also be useful persons to interview.

Court administrators are also useful persons with whom to speak. Such persons may be clerks who handle the court's caseload, or who are working on matters such as budgets, computerization, training, etc. Of course, lawyers and businesspersons as End Users, will also provide useful insight into the functioning of the courts.

During the interviews, many will tend to speak in generalities and abstractions about the court system (e.g. description of the process as too long, ineffective, corrupt, etc). The Interviewer should try and press

for specifics: examples of specific contract disputes; reference to existing decisions and judgments (precedent). Concrete examples are useful because the interviewer can mention these same cases or facts when meeting with subsequent End Users. Additionally, concrete examples, when mentioned in the diagnostic report, can be double checked by other experts who may review and comment on the diagnostic report.

Courts: Organization. These questions ask whether the law provides the courts with a clear mandate and structure for resolving commercial contract disputes. To some extent, these questions are replicate questions in the Legal Framework section about implementing institutions. A segment of questions relate to resources. Interviewees are asked to assess the level of financing, staff and other resources provided to the court system and whether there appears to be substantial commitment by the government for an effective court system.

In the narrative text, the Interviewer should explain the structure and levels of the court systems, delineating courts of first instance and appeals. While such a structure is not expressly scored, it is essential for understanding the overall court system. It also allows the diagnostic team to highlight issues related to commercial law and transactions, which is the subject of the scoring. Problems of excessive jurisdiction (e.g., the same courts cover securities transactions and custody disputes) should be addressed in this section of the narrative.

Courts: Operations. The operations segment focuses on how effective the courts are in resolving disputes in a fair, transparent and timely fashion. Certain questions focus specifically on the business community's perceptions of the court system. Additional questions also focus on how well the court disseminates information. In practice, this section provides the most significant comments and assessments of the court system. Issues of competence, efficiency, and fairness should be explored carefully with End Users.

In addition, the entire diagnostic team should coordinate and collaborate on these answers, as all team members will have court-related questions within their areas of law. Rather than concentrate exclusively on Contracts in the discussion, it is useful to note problems identified in other areas of law here, either as cross-references to the relevant specialized section, or as a full discussion. For example, the courts may be generally effective in interpreting and enforcing sales contracts, but completely ineffective with respect to Foreign Direct Investment or Collateral. As with notaries, Contracts provides a logical focal point for a comprehensive discussion of the court system.

Government Contracts and Administrative Decisions. A shorter segment focuses on the role of administrative tribunals in resolving disputes between private persons and the government. The questions ask whether there are appropriate procedures and regulations in place for such bodies and whether they appear to render decisions in a fair and transparent manner. Although short, this segment can be significant, especially in countries where the government continues to play an important direct role in the economy through commercial transactions. Indeed, even in highly developed market economies, the government (at the national and local levels) is one of the single largest purchasers of goods and services in the country.

The diagnostic team should look closely at two issues under this section. First, the Interviewer should ascertain how far the legal culture has progressed from the historical doctrine that "the king can do no wrong." That is, to what extent does the government submit itself to suit under the commercial exception to general doctrines of sovereign immunity. In the West, these legal developments advanced heavily during the middle of the twentieth century, just when many countries in the Soviet Bloc were moving in the opposite direction.

Second, the Interviewer should concentrate on practical issues of fairness. Even though the law may provide for the government to be subject to the law in the same way as a commercial enterprise, the administrative courts may unfairly stack the deck. This bias is not always in favor of the government -- in some countries there were reports that the government was presumed to be at fault and generally lost! Either way, the Interviewer should confirm whether practice follows theory.

3. Supporting Institutions

The main emphasis of the Supporting Institutions questions is twofold: (i) whether certain entities exist and provide services; and (ii) whether they are effective. The questions are broken down by category.

The first category is **government entities** – which include notaries and bailiffs. Very often notaries will also be lawyers and therefore it will be relatively easy to meet notaries. There may also be a notary association. Bailiffs, on the other hand, may not be included as part of the interview schedule. It will be important, therefore, to ask judges or other court administrators about the role of bailiffs or other persons vested with the duty of enforcing judgments. Better yet, the Interviewer should schedule time with one or more bailiffs.

The second category of supporting institution includes **professional associations**. These groups include lawyer's associations (i.e., bar associations) and law professors. The questions focus on the role of lawyers in terms of developing expertise and knowledge in the contract law and practice. A subset of questions focuses on the role of professors/academicians in publishing contract treaties and other books and the role of universities in educating future generations of lawyers about contract law. With respect to this last question, it is helpful to meet with law students or lawyer trainees to get a sense of what they learned during their legal education and their assessment as to whether such training is sufficient or could be improved. If the interviewer has a meeting at a university, he or she could ask for a brief meeting with students.

The third category of question relates to **specialized services.** In particular, these questions focus on whether commercial arbitration is available as a viable alternative to the court system. The views of businesspersons as well as lawyers are critical to answering this question. Additional question ask about the existence of legal periodicals and reference materials. The availability of information about law, legislative reform and judicial decisions is an integral part of a well functioning legal system. Therefore, these questions are as important as earlier questions about the courts and the judiciary.

The fourth category of supporting institutions is **trade and professional associations**. These organizations might include chambers of commerce, or sector specific organizations such as a bankers association, retailers association, group of smaller merchants, auricular groups, etc. To the extent that such organizations exist, they may provide insight into how well the court system functions for resolving disputes, and also whether the business community feels that they have wide latitude in terms of the substantive provisions included in contracts. These associations may (or may not) be active in proposing standardized contracts or in lobbying for change in contract law and procedure. These organizations may also offer their own type of dispute resolution services for members such as a mediation service or some type of industry wide arbitration. In many jurisdictions, for example, brokers or the stock exchange offers dispute resolution for securities disputes.

4. Market for Contract Law Reform

The market segment measures the demand from End Users in terms of contract law reform and the supply from the government in terms of legislative change or reform to processes in respond to the demand. Based on the interviewer's assessment of the supply and demand for contract law reform, he or she may have specific recommendation as to areas for follow up. These suggestions are often ones that emerge during interviews. For example, in one jurisdiction surveyed during the C-LIR pilot project, many respondents noted that the legislative amendment process had been quite closed with respect to the reform of the law on obligations. Consequently, many End Users desired greater transparency and collaboration in the legislative drafting process. To the extent that donor agencies are trying to identify projects to support, the market section facilitates this process.

Market for Improved Laws. The "demand" side questions ask to what extent politicians and private individuals or entities are actively asking for and participating in reform to the extent changes are proposed. The supply side gauges the extent to which the government has responded to a demand in terms of initiating legislative reform. Some of these questions are, by necessity, more general questions about the legislative process. In other words, the questions ask to what extent End Users can participate in and comment on the legislative process more broadly and to what extent the government is responsive to such participation.

If Contract law is deemed sufficient in terms of Legal Framework, it may be that there is no demand for change at present. The interviewer should be sensitive to the timing of changes in the law. For example, if the civil code was reformed several years ago, it might be useful to ask the End Users about how much of the reform was due to demand from the government or from private parties. Similarly, the interviewer could ask about how involved the End Users were at this time. If the process for drafting or amending laws has improved over time, the interviewer should take note of this change and score the country based on the more recent positive experiences.

This difference between demand for legal change and the demand for systemic change is important. During the assessment of one country, it became clear that there was little demand for any significant change in the law, which was generally quite good. Respondents felt that minor modifications were needed and could be taken care of as needed. When asked about how they would communicate the need for modification to the legislature, it became apparent that there was no mechanism for interactive legislative process or amendment. This may be true for a number of countries, and the Interviewer should look for such issues and problems.

Market for Implementing Institutions. The demand questions with respect to Implementing Institutions focus on how actively the government and the private sector work to improve the court's performance with respect to commercial contract disputes. Are the government and business entities actively calling for increased performance, clearer decision-making and improved processes? Very often this question will boil down to a matter of perception. Do End Users such as businesses feel confident in using the courts to resolve disputes? In addition, if so, are they actively bringing cases to court?

The supply side gauges the response of the courts to such demand. Are the courts working internally to improve their administration, decision-making and training processes? Have there been marked improvements in reducing the length of lawsuits? The supply questions also ask End Users to provide a subjective assessment of the quality of services "supplied" by the courts. Are they satisfied? Each question relating to private sector supply focuses on issues of satisfaction and confidence. These questions are vital to the diagnostic because they provide an important glimpse as to whether End Users are satisfied with the implementation of laws and the services provided by the courts in furtherance of their legal mandate.

Market for Supporting Institutions. The demand questions with respect to Supporting Institutions have to do with the level of existence of associations and their participation in the legal reform process. Do professional groups actively seek change? Is demand so well defined and developed that they have special sections dedicated to Contract Law issues? Do trade groups seek special modifications in the law based on their business needs? To the extent that there is not a robust civil society involved in these issues, the Interviewer should try to understand why. In some countries, the lack of active trade or foreign investment may be the reason. In others, the government may have control over trading associations (i.e., through creation of state sponsored chambers of commerce or investment promotion entities). On the other hand, there may not currently be enough demand to drive such responses. In this case, the diagnostic assessment may recommend that resources be allocated to an area where greater demand is likely to lead to greater local involvement and ownership of the process.

F. Foreign Direct Investment

Foreign Direct Investment (FDI)is a lens through which a country's overall investment environment can be studied, providing insight into *all* investment, not simply that made from abroad. Foreign investors are often more sophisticated than local investors in newly emerging market economies, and are more mobile -- they are not captive to the local market, but go where the best opportunities lie. If a country cannot attract foreign investment effectively, it is unlikely that the environment is healthy for local investors either.

On the other hand, the diagnostic team should be aware of an opposite problem: discriminating against local investors in favor of foreign capital. As a general rule, foreigners will not invest in much other than extractive industries unless locals are also investing actively in their own country. Excessive attempts to attract foreign capital usually indicate an unhealthy climate for local investment, often based on poor understanding on the nature of capital. Moreover, productive small businesses provide the infrastructure for larger investment and are the backbone of the local economy. In the United States, mega-firms such as General Motors rely on hundreds or even thousands of small businesses to supply their service and manufacturing needs. Without a healthy local investment climate, large foreign firms are unlikely to find the local market attractive for investment, no matter how generous the incentives.

The diagnostic team should be aware of both sides of discrimination and should benchmark their assessment against a standard of non-discrimination that recognizes the unique needs of foreign investors, but neither unduly courts or inhibits FDI.

1. Legal Framework

There is an ongoing debate whether countries should even have a foreign investment code or other set of FDI laws. Those opposed point out that the United States, with the highest levels of direct foreign investment in the world, does not have a foreign investment code, but has an attractive investment climate with few restrictions based on the source of capital or nationality of investors. On the other hand, policymakers in many transition and developing countries recognize that they need to actively seek foreign investment, and use the code as a way to compile and package their relevant incentives and restrictions for promotional purposes. Other countries, however, established FDI laws during their socialist years based on ideology that saw foreign investment primarily as capitalist exploitation that must be carefully controlled.[7]

[7] Countries with this attitude generally do not have much foreign investment to control, other than extractive investment in petroleum and other minerals. Investors tend to prefer countries where they are welcome.

For the diagnostic team, these different approaches mean that the assessment should not be based on whether there is a comprehensive FDI law in place (in which case many of the most attractive countries in Western Europe would fail miserably), but whether the laws affecting foreign investment are readily apparent and ascertainable prior to investing. The framework is likely to consist of several distinct areas of legislation, which may be compiled only by international accounting firms or foreign promotion agencies. The search for relevant legislation should provide the diagnostic team with ample understanding of the Legal Framework, even if there is no FDI code.

The diagnostic indicators for FDI address this problem by enumerating a number of laws and treaties that should be examined by the diagnostic team. However, the assessment begins with issues regarding equal treatment. Best practices internationally require that foreign and domestic investors should be treated the same for most purposes. Moreover, foreign investors should not have to prove themselves through special targets or production requirements. (Neither should local investors, but all investors should be subject to the same burdens.) Minimum domestic capital ownership requirements have been popular in some countries to ensure local participation and growth, but such laws eventually produce a secondary market in proxy investors, or else create a system of legalized extortion by which the local "investor" can unduly influence business decisions. The diagnostic team should look for explicit discrimination (or prohibitions of discrimination) in the laws, but also ask respondents about discriminatory practices that do not appear in the relevant legislation.

Although rules should apply equally to foreign and domestic investors, foreigners do have some unique needs. Most obvious among these is the need to be able to repatriate profits, make payments to foreign suppliers in foreign currency, and transfer proceeds out of country in the event of liquidation. In other words, foreign investors need to be able to get their money out of the country, whereas this is not always true for domestic investors. The diagnostic team should look for such restrictions and liberties, but should provide higher scores if neither domestic or foreign investors are subject to currency controls.

Foreign investors also have special considerations with regard to the threat of expropriation. International law requires just, adequate, and speedy compensation to foreign investors in the event of expropriation, no matter what the cause (other than criminal sanctions). The diagnostic team should examine the laws to see if there are statutory protections, and should also determine whether the government has a history of expropriation. Likewise, unexpected legislative changes can have the same impact as expropriation, so that the law should provide for compensation, grandfather clauses, or transition periods for compliance with new requirements. More importantly, however, investors should be able to have the confidence that the underlying framework is essentially stable and not likely to be tampered with significantly over time. Some countries learn this lesson only as they watch investors disappear as they exercise their sovereign right to change the laws.

Unequal treatment frequently appears when disputes arise, with some local court systems being notoriously biased against foreign litigants. To protect against this, the law should permit foreign investors to have forum and choice of law clauses in their contracts, as well as to choose binding arbitration in appropriate circumstances. (The diagnostic team should expect reasonable limitations on this right, otherwise the foreign investor can enjoy reverse the injustice by requiring, for example, that employment issues be settled by binding arbitration abroad, eviscerating the capacity of employees to bring complaints.)

A few comments are needed for the generally self-explanatory auxilary laws of question 22. First, it should be noted that the question focuses not on the law, but on the investors' impressions of the law. The foreign investor community applies a comparative standard based on treatment in other countries. Thus these impressions do not consider whether the local legislators believe their laws to be attractive, but whether they are in fact attractive to foreign investors.

The question regarding minimum capital requirements is not intended to indicate that there should be minimum capital requirements. Many countries mandate levels of initial capitalization, reserves, or working capital. The general advisability of such requirements is not at issue hear, but whether the FDI community finds them unduly burdensome. The interviewer should provide higher scores for higher levels of satisfaction.

Investment incentives are another area of controversy, with many in the C-LIR community opposed to incentives that are limited to foreign investors. Questions 25 and 26, however, focus on different aspects, so that the diagnostic team should be certain to address the issues of discrimination separately in the narrative text. These indicators address transparency and predictability in awarding approval for incentives. In addition, the interviewer should be careful to distinguish between whether approval is required to receive incentives -- such as tax reductions -- or for the investment itself. Not all investors care about or qualify for the incentives offered, but some countries insist on approving or denying all investments. The difference has a significant impact on the overall level of investment.

2. Implementing Institutions

Most countries have some sort of agency responsible either for promoting or monitoring FDI. Often this is a "one stop shop" with a mandate to provide all relevant information regarding investment opportunities and incentives, and to assist the potential investor with setting up interviews and filling out forms. This agency may also be the entity responsible for approving investment incentives.

The diagnostic indicators do not favor any particular form of agency, or a single entity over several. The focus is on the effectiveness of the structure and staff, and on the services provided. The diagnostic team should adapt the questions as appropriate to cover the type of structure.

Interviewers should also seek to understand the promotion model being used. Many countries do not have any background in marketing or sales promotion, having lived for decades in a controlled economy. As a result, there can be much confusion over the nature and purpose of marketing and promotion. Some Investment Promotion agencies put out high quality information brochures for investors who come looking for opportunities, but do not know how to target potential investors and promote effectively abroad. This reactive model tends to provide little more than jobs for the staff, who are generally well meaning but ineffective. In addition, many do not understand the nature of global competition, and thus structure their programs and incentives on mistaken assumptions. By probing these areas, the interviewer can identify assistance needs of both the agency and the sponsoring ministry with respect to investment promotion and market understanding.

Interviewers should ensure that the agency is assessed from a number of angles, especially that of the foreign investor. In addition, the interviewer should talk to other relevant agencies, ministries, and even legislative committees to ascertain their evaluation of the FDI agency. This broad approach is needed to verify whether there is, in fact, a common understanding of the agency's mandate.

Courts can also serve as an Implementing Institution as they interpret and apply the FDI law in litigation by or against the investors. Again, the interviewer should be on the lookout for discriminatory behavior as well as the professional capacity of the courts to understand and interpret the law properly. It is also important to note whether they actually respect and enforce arbitral awards and other alternate dispute decisions.

3. Supporting Institutions

For **government entities**, there are several significant Supporting Institutions. First, notaries often hold a monopoly position for approving or disapproving various documents and contracts. They are therefore capable of either facilitating or constraining foreign investment. In talking with foreign investors, the interviewer should ask for comparative analysis between experiences in the subject country and in other countries with respect to notaries. The interviewer should also weigh the impressions of Americans, who may not be accustomed to the European notarial tradition, against investors from similar other backgrounds.

The Customs Service, which also plays a role in Trade Law, acts as a Supporting Institution under FDI. The focus of the diagnostic team in this area of law should be primarily on the extent to which the service facilitates or constrains foreign investment through its implementation and interpretation of relevant laws.

In addition, though not expressly noted in the indicators for this section, there are numerous agencies and departments that issue permits, licenses, and authorizations, from visas to construction to import of inputs. If these issues are not managed by the investment promotion authority, the diagnostic team may wish to identify principle entities and their impact on investment. Again, discrimination (including price discrimination) is a common problem for foreigners who must "know someone" to get what their needed permits instead of simply complying with published requirements.

Foreign investment often enhances or encourages **professional associations** by the needs of multinational corporations to comply with international standards. These investors are more likely to need and use International Accounting Standards (IAS) than many local businesses, and can be a driving force in developing local capacity for such standards. Likewise, legal agreements with FDI often require more sophisticated contracts and corporate structures than local investors employ, requiring international expertise in the bar association to represent the investors and to negotiate with investors on behalf of counterparts. The diagnostic team should be aware of these dynamics and look both at the quality and quantity of the supply of professionals to support FDI and the impact of FDI on these associations. A finding of insufficient expertise can lead to programs of support (sometimes with professionals from foreign investors contributing to professional development).

Specialized services come into the international comparative spotlight under FDI. Whereas local investors may be content with poor service in some countries, having never experienced better, foreign investors are less likely to put up with this. Foreign investors can provide insightful commentary on how local services measure up to international standards and best practices; they can also help direct existing services into new areas as they request market studies and seek to influence traditional management practices with new approaches.

The diagnostic team should look for support for and resistance to FDI within the **trade and special interest groups.** Foreign investor associations often form effective lobbying groups to open the economy, or some specific aspect affecting their interests, while bi-lateral chambers of commerce can serve a similar function, but with a membership more representative of shared local interests. Trade groups and labor unions can be among the greatest opponents of change, especially when local industries are struggling to survive against imported goods or new and efficient foreign investors. Popular misunderstandings are well characterized by recent highly publicized attacks on McDonald's restaurants in several countries, where foreigners are being blamed for economic ills coming from past mistakes.

Of course, trade and special interest groups can be the greatest proponents of change also. Manufacturers and exporters may recognize the need for new technology or strategic partnerships that have been hin-

dered by the FDI framework. The interviewer should look for all of these trends, and seek to interview a wide variety of these groups when time permits.

4. The Market for Increased Foreign Direct Investment

As noted throughout this section, the market for FDI is fraught with pitfalls and competing interests. Local investors sometimes invoke nationalist sentiments to keep foreign investors out, or to seek discriminatory and anti-competitive restrictions. Some policymakers see foreign enterprises as cash cows that should be milked for every drop of revenue available, imposing additional fees and taxes. When foreign investors engage in corruption, the backlash can be formidable.

On the other hand, some countries discriminate in favor of foreign investors and against local players. In 1999, Romania essentially "gave away the store" in with excessive incentives and promises to attract foreign corporations, then had to renege after it became clear that the incentives were dangerously undercutting the nation's revenue base. This immature focus on attracting hard currency is just as dangerous as discriminating against foreigners.

In examining the Market for reform, the diagnostic team should attempt to identify the various interests, their relative influence, and the level of understanding among differing proponents of the potential benefits of a non-discriminatory investment environment. The paucity of market economics training among professionals and non-professionals is one of the greatest barriers to reform in many countries (including advanced developed countries). A review of local media coverage of these issues, as well as election campaign rhetoric, will generally yield important information on difficult-to-quantify local sentiments. The diagnostic team can probably obtain such information from embassies and bilateral chambers of commerce.

G. Trade

The C-LIR diagnostic methodology for Trade Law examines only cross-border or international trade. Some trade specialists also point out that *intra*national trade (for example, between distant regions within a country, or between cities and rural areas) may also be an important sector for analysis, but that is not the subject of this study. Such domestic issues tend to focus on infrastructure instead of legal reform.

The diagnostic team should look at two separate aspects of trade where appropriate: global trade, as governed by the World Trade Organization (WTO), and regional trade, which may be governed principally by bi-lateral or regional agreements. This is particularly significant for countries whose domestic market is limited by size or wealth. In such countries, the trading relationships with neighboring countries will define the market size for investors, and will either attract or repel foreign direct investment, while affecting the export and re-export service industries. For former colonies, the diagnostic team should also note any significant differences between regional trade relationships and the relationships with the former colonial power. These may present areas where programmatic assistance can strengthen the trading patterns that may have been limited by a colonial legacy.

The diagnostic team should have a strong familiarity with trade law within the context of the World Trade Organization rules and agreements. Although a number of areas assessed are not explicitly related to the WTO, most issues are now or will eventually be measured against WTO standards.

1. Legal Framework

Diagnostic indicators for the Legal Framework focus on three distinct areas of law: the general environment for trade, customs and the tariff regime, and non-tariff barriers. Unlike all other areas, this section does not ask whether there is a general framework law in place -- most trade issues are regulated by international treaties and agreements limiting the behavior of governments, not private sector actors, hence there is not a trade "code" regulating these rules, but a system of agreements. Membership in the WTO approximates this requirement, however.

The **general environment for trade** examines international agreements and domestic laws. The diagnostic team should determine the country's membership status in the WTO, regional arrangements, and bilateral agreements with neighbors or important trading partners. The scoring system does not provide for separate scores for each agreement, but the team should enumerate the findings within the narrative text. This information provides a clearer picture of the country's position in the international trading community.

The indicators also verify the presence of agreements with three specific entities: the European Union, the United States, and Japan. These three represent the three major trading powers in the world, but the diagnostic team may not find each of them relevant for the particular country under study. In this case, the team should feel free to make substitutions, explaining the reasons within the text. For example, a diagnostic of Malawi might emphasize South Africa over the United States.

Other indicators focus on the domestic environment. The diagnostic team should determine whether the state monopolizes trade in any specific goods or services, whether the competition law prohibits private sector monopolies, and whether import/export licensing laws unduly restrict trade. The team should also determine whether national policy is enforced within districts or regions, otherwise a national trade regime can be eviscerated by practices at principle borders or in important commercial districts. Finally, the assessment should include an examination and discussion of what policy instruments are used to regulate trade. For transparency purposes, tariffs should be the primary instrument, and variations should be specifically noted.

The **customs and tariff regime** indicators are relatively straightforward. The methodology awards higher scores to countries whose regime is based on international standards (the Harmonized Tariff Schedule), provides non-discriminatory treatment through most-favored nation provisions, and accords national treatment to foreign goods and services. The quality of the customs service itself is examined Supporting Institutions.

Non-tariff barriers are as important as tariff barriers, but often harder to detect. The diagnostic team should look not only at what the law requires, but whether any specific nationalities or industries are subject to discriminatory treatment. This information will come primarily from interviews and may be difficult to verify. Importers are often the best source of information, especially importers of goods that compete with local products or with long-standing trading partners. For example, some African nations use licensing rules, delays in processing, excessive inspections, and inappropriate valuations to hinder importation from countries competing with a former colonial power. (These practices are sometimes encouraged by the former power.) The diagnostic team will also want to interview commercial attaches at embassies and personnel from donor projects providing any trade reform assistance.

2. Implementing Institution

The Implementing Institution for the diagnostic has been generically labeled as the Trade Commission. Different countries will have other titles, but the institution intended is that entity responsible for compliance with WTO requirements, or, in the absence of WTO membership, any other relevant trade laws and

agreements. In some cases, the functions set forth in the indicators (oversight of customs, issuance of import/export licenses) may be handled by other agencies, so the diagnostic team will need to ascertain the scope of authority for the principle institution, and whether other institutions cover some of the functions.

In the event that there are several Implementing Institutions, the questions regarding organization and operations should be applied to each, as appropriate. The narrative discussion should be used to explain the situation and the impact on scoring.

Unlike most other areas of law in this diagnostic, the indicators regarding the Implementing Institution for Trade specifically ask about the issue of corruption. Corruption can be an issue in any area of implementation and enforcement, but is frequently found in the area of customs in poorer countries and in countries undergoing dramatic socio-economic or political transitions. Diagnostic teams should look at the environment giving rise to such practices, such as poor training, low pay, discretionary authority, and lack of effective government programs to combat the problem. While it is difficult, if not impossible, to eliminate such behavior, progress can often be made through changed, transparent procedures and other reforms. The assessment can uncover useful information for designing such programs.

3. Supporting Institutions

The first indicator for Supporting Institutions appears at first glance to repeat the starting question for Implementing Institutions. The diagnostic team should note that this question focuses on the subset of customs law, rather than trade law, and fits within the definition of the customs service as a **government entity** Supporting Institution. Otherwise, the indicator is the same. There are additional questions focusing entirely on the entity responsible for implementation of the customs law.

While the scores reflect the degree of modernization in the customs service (the use of web sites to provide information), the narrative analysis should be concerned with the overall characterization of the service as an asset or hindrance to trade. It is quite possible to have a well organized, technologically savvy service that impedes or distorts trade on a constant basis. Likewise, a well run service may lack modern tools but have an excellent record in processing imports and exports expeditiously in accordance with law. The diagnostic findings should be fashioned to provide information necessary for project assistance on a more fundamental level. Computerization of confused processes only leads to computerized confusion: the diagnostic team should be aware of this.

Although not expressly mentioned, the team should also look into the quality of trade statistics generated. The local World Bank or International Monetary Fund representatives can be very helpful in providing information on the government's capacity to collect and analyze trade statistics. In addition, the European Union frequently provides technical assistance in this area and should be consulted.

For **professional associations**, the diagnostic team should ascertain the level of expertise development primarily for lawyers and economists. The bar association may have specialized sections; if not, there should be at least a few lawyers working for the government or for importers and exporters who specialize in trade laws. The diagnostic team should ascertain whether they or trade economists are actively pursuing Trade Law reforms. Other associations may also have active trade-related programs.

Perhaps the most significant of the **specialized services** for this diagnostic area is in the area of inspection. Valuation and payment for goods hinges on professional inspection of contents, which are often provided under concession agreement or contract to international inspection services. If the services are

offered by local providers, the interviewers should ascertain from the End Users how well they apply international standards or rate compared to services in other countries.

The existence of warehouses, in-bond schemes, and freight forwarding services also indicates the health and development of the trade community. Representatives of these services are excellent sources for both statistics and personal opinions regarding problems and needs in the trade arena. The diagnostic team should also note the degree to which professional "expeditors" are required to shepherd shipments through the system. In a healthy trade environment, company representatives can handle import and export, perhaps with some assistance from freight forwarders. In countries where bureaucratic requirements are excessive, there will be an established cadre of professional expeditors who stand in lines, fill out forms, negotiate contradictory requirements, and otherwise grease the wheels of commerce. Not only are they an indicator of the need for reform, they are usually vocal opponents of simplification and rationalization, which will make their jobs unnecessary.

As with Competition Law, **trade and special interest groups** are likely to represent competing interests in the globalization of trade. Bilateral chambers of commerce and retailers' associations are likely to support liberalization, while manufacturers' associations may support protectionist policies, with exceptions for imported inputs. The challenge for the diagnostic researcher is to determine which groups are winning the arguments with policymakers.

4. The Market for Trade Liberalization

Trade negotiations take place between governments, and so it is essential that government champion the cause of liberalization if there is to be success. Even if there is a strong lobby by private sector interests, their efforts can easily be thwarted by official intransigence. The issue of revenues, however, tends to be a driving force behind demand for change, but only if the government is willing to trade higher tariffs for higher volume at lower tariffs, or recognize that revenues from increased economic activity (and collected at other sources) should increase as tariffs fall. Interviewers should try to identify competing schools of thought within the government, as well as competing interests with the power to influence the government.

Foreign investor associations, banks dealing in trade finance, and import/export companies are likely to provide much information regarding frustrations and successes in reforming the trade regime. Economists are also important as proponents (and even opponents) of liberalization, and should be sought out to help the team understand the economic implications for the country and likelihood of success. Lawyers are useful in observing the quality of implementation, but are not always aware of policy implications. Even so, attorneys for companies who depend on liberalized trade are likely to be involved in influencing trade policy, and should be interviewed.

The market for reform of the customs service will probably be the best defined market under Trade Law. The import/export community (including freight forwarders, warehouse owners, and transporters) will usually be among the strongest advocates of liberalization on the demand side, as they profit directly from the increase in trade. Importers and exporters will also be vigorous advocates because unnecessary delays and inappropriate fees have a direct impact on their profitability. On the other hand, in some countries the larger importers have found ways around enforcement, and will resist efficiency. New entrants and smaller actors will need to influence policymakers through their concerted efforts in order bring about change.